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No. 90-

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

AMCA INTERNATIONAL FINANCE COMPANY, et al.,
Petitioners,

VS.

STEVEN K. HILGEDICK, etc., et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, FIRST APPELLATE DISTRICT

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QUESTIONS PRESENTED

1. Whether California's punitive damages scheme, which gives juries essentially standardless discretion to award punitive damages in virtually limitless amounts and thereby deprives tort defendants of advance notice of the amount of punishment that may be imposed for a given course of conduct, violates the Due Process Clause of the Fourteenth Amendment.

2. Whether the Due Process Clause of the Fourteenth Amendment proscribes awards of punitive damages that are grossly disproportionate to the harm caused and far in excess of the amount needed to punish and deter, and, if so, whether the $8.5 million punitive damages award imposed in this case exceeds those limits.

3. Whether the Due Process Clause of the Fourteenth Amendment prohibits a state from imposing tort liability and punitive damages for conduct that, on its face, was permitted by the express terms of valid and lawful contracts between the parties, where nothing in the state's law provided any warning that such conduct was forbidden.

LIST OF PARTIES

Petitioners

Koehring Finance Corporation (now known as AMCA International Finance Company).
Koehring Company (now known as AMCA-Koehring Company).

Respondents

Steven K. Hilgedick, as an individual and doing business as Hilgedick Rental Company.
Pacific Manufacturing Company.

These parties are identical to those in the proceedings below.

RULE 29.1 LIST

The following constitutes a list of all parent companies and affiliates of petitioners: petitioner Koehring Finance Corporation (now known as AMCA International Finance Company) and petitioner Koehring Company (now known as AMCA-Koehring Company) are wholly owned by United Dominion Industries, Inc. (formerly known as AMCA International Corporation), a Delaware corporation. United Dominion Industries, Inc. is wholly owned by United Dominion Industries, Limited (formerly AMCA International, Limited), a publicly held Canadian corporation. Canadian Pacific, Limited, a publicly held Canadian corporation, owns 55.41% of United Dominion Industries, Limited.

RULE 29.4(C) NOTICE

28 U.S.C. § 2403(b), which provides for notice to, and intervention by, a state where the constitutionality of a state statute is drawn in question in a federal court, may be applicable in this case.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES	ii
RULE 29.1 LIST	ii
RULE 29.4(C) NOTICE	ii
OPINION AND ORDERS BELOW	1
JURISDICTION	2
CONSTITUTIONAL PROVISION INVOLVED	2
STATEMENT OF THE CASE	2
A. The Parties	3
B. Statement of Facts	4
C. The Proceedings Below	6
D. Presentation and Decision of the Federal Constitutional Questions	7
REASONS FOR GRANTING THE WRIT	9
ARGUMENT	12
I.	
CALIFORNIA'S PUNITIVE DAMAGES SCHEME, WHICH ALLOWS JURIES ESSENTIALLY UNFETTERED DISCRETION TO INFLICT PUNISHMENT IN VIRTUALLY UNLIMITED AMOUNTS, VIOLATES THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT	12
A. Statutes Authorizing the Imposition of Punitive Damages Are Subject to the Due Process Proscription Against Vague Laws	12

TABLE OF CONTENTS

Page

B. California Law Provides No Meaningful Objective Standards for Juries to Follow in Setting the Amount of Punitive Damages Awards. As a result, Defendants Have No Advance Notice of the Amount of Punishment That May Be Imposed 14

C. The Availability of Appellate Review or the Potential for Remittitur Does Not Cure the Unconstitutionality of California's Punitive Damages Scheme 19

II.

THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT PROHIBITS JURY AWARDS OF PUNITIVE DAMAGES IN AMOUNTS THAT ARE OPPRESSIVE AND BEAR NO REASONABLE RELATION TO THE INTERESTS IN RETRIBUTION AND DETERRENCE 21

A. The Due Process Clause Places Outer Limits on the Amounts of Punitive Damages That Can Be Awarded by Juries in Civil Cases 21

B. The $8.5 Million Award of Punitive Damages Assessed Against Petitioners Is So Oppressive and Disproportionate to Petitioners' Culpability as to Render the Award Constitutionally Excessive 23

TABLE OF CONTENTS

Page

III.

ABSENT PRIOR NOTICE, THE IMPOSITION OF TORT LIABILITY AND PUNITIVE DAMAGES FOR CONDUCT ALLOWED BY VALID AND LAWFUL CONTRACTS VIOLATES THE PRINCIPLE OF FAIR WARNING INHERENT IN THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT 25

A. The Due Process Clause of the Fourteenth Amendment Guards Against the Imposition of Liability in the Absence of Advance Warning That Conduct Is Prohibited 25

B. Petitioners Were Deprived of Fair Warning That Conduct in Accord With the Express Terms of Their Valid and Lawful Contracts Would Expose Them to Tort Liability 26

CONCLUSION 29

TABLE OF AUTHORITIES

Cases

Page

Allard v. Church of Scientology, 58 Cal.App.3d 439, 129 Cal.Rptr. 797 (1976), certiorari denied, 429 U.S. 1091 (1977) 17

Auto Equity Sales v. Superior Court, 57 Cal.2d 450, 20 Cal.Rptr. 321, 369 P.2d 937 (1962) 8

Baggett v. Bullitt, 377 U.S. 360 (1964) 19

Bankers Life & Casualty Co. v. Crenshaw, 486 U.S. 71 (1988) 18

Bertero v. National General Corp., 13 Cal.3d 43, 118 Cal.Rptr. 184, 529 P.2d 608 (1974) 8, 12

Bouie v. City of Columbia, 378 U.S. 347 (1964) 11, 26, 28, 29

Browning-Ferris Industries v. Kelco Disposal, Inc., __U.S.__, 109 S.Ct. 2909 (1989) 9, 12, 22

City of Mesquite v. Aladdins Castle, Inc., 455 U.S. 283 (1982) 13

City of Newport v. Fact Concerts, Inc., 453 U.S. 247 (1981) 13

Daniels v. Williams, 474 U.S. 327 (1986) 21

Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., 155 Cal.App.3d 381, 202 Cal.Rptr. 204 (1984) 15, 19, 20

Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co., 189 Cal.App.3d 1072, 234 Cal.Rptr. 835 (1987), certiorari denied, 486 U.S. 1036 (1988) 12, 17, 24

Dyna-Med, Inc. v. Fair Employment and Housing Com., 43 Cal.3d 1379, 241 Cal.Rptr. 67, 743 P.2d 1323 (1987) 13

Eichenseer v. Reserve Life Ins. Co., 881 F.2d 1355 (5th Cir. 1989), certiorari pending (No. 89-1303) .. 3

TABLE OF AUTHORITIES

CASES

Page

Farajpour v. University of Southern California, 221 Cal.App.3d 19, 270 Cal.Rptr. 356 (1990) 20

Ferraro v. Pacific Fin. Corp., 8 Cal.App.3d 339, 87 Cal.Rptr. 226 (1970) 20

Finney v. Lockhart, 35 Cal.2d 161, 217 P.2d 19 (1950) 17

G. Amador Corporation v. Ohio Casualty Insurance Company (No. B029795, 12/29/89), petition for certiorari filed June 19, 1990 (No. 89-1986), certiorari dismissed pursuant to Supreme Court Rule 46, 111 S.Ct. 288 (1990) 20, 24

Gertz v. Robert Welch, Inc., 418 U.S. 323 (1974) ... 10, 16

Giaccio v. Pennsylvania, 382 U.S. 399 (1966) 11, 13, 16, 25

Grayned v. City of Rockford, 408 U.S. 104 (1972) ... 12-13

Grimshaw v. Ford Motor Co., 119 Cal.App.3d 757, 174 Cal.Rptr. 348 (1981) 8

Hasson v. Ford Motor Co., 32 Cal.3d 388, 185 Cal.Rptr. 654, 650 P.2d 1171 (1982) 12

Hospital Authority of Gwinnett County v. Jones, 386 S.E.2d 120 (Ga. 1989), certiorari pending (No. 89-1315) 3

Hurtado v. California, 110 U.S. 516 (1884) 21

Imperial Ice Co. v. Rossier, 18 Cal.2d 33, 112 P.2d 631 (1941) 28

Int'l Brotherhood of Electrical Workers v. Foust, 442 U.S. 42 (1979) 10, 16

Kolender v. Lawson, 461 U.S. 352 (1983) 13

Land Associates, Inc. v. Simmons, 562 So.2d 140 (Ala. 1989), certiorari pending (No. 90-73) 3

TABLE OF AUTHORITIES

CASES

Page

Lawless v. Brotherhood of Painters, 143 Cal.App.2d 474, 300 P.2d 159 (1956) 28

Leonardini v. Shell Oil Co., 216 Cal.App.3d 547, 264 Cal.Rptr. 883 (1989), certiorari denied, 111 S.Ct. 293 (1990) 20

Little v Stuyvesant Life Ins. Co., 67 Cal.App.3d 451, 136 Cal.Rptr. 653 (1977) 17

Massachusetts Mutual Life Insurance Co. v. Collins, No. 88-949 (Ala. 1990), certiorari pending (No. 90-244) 3

Missouri Pacific Ry. Co. v. Tucker, 230 U.S. 340 (1913) 11, 21-22

Moradi-Shalal v. Fireman's Fund Ins. Companies, 46 Cal.3d 287, 250 Cal.Rptr. 116, 758 P.2d 58 (1988) 8

Pacific Lighting Corporation v. MGW, Inc. (Cal. App. 1990), certiorari pending (No. 90-626) 3

Pacific Mutual Life Insurance Co. v. Haslip (Docket No. 89-1279), certiorari granted, 110 S.Ct. 1780 (1990) 2-3, 9

Papachristou v. City of Jacksonville, 405 U.S. 156 (1972) 13

People ex rel. Dept. of Transportation v. Grocers Wholesale Co., 214 Cal.App.3d 498, 262 Cal.Rptr. 689 (1989) 12

Roberts v. United States Jaycees, 468 U.S. 609 (1984) 19

Rosener v. Sears, Roebuck & Co., 110 Cal.App.3d 740, 168 Cal.Rptr. 237 (1980) 9, 10, 16, 19

Santosky v. Kramer, 455 U.S. 745 (1982) 19

TABLE OF AUTHORITIES

CASES

Page

Security Pacific National Bank v. Williams, 213 Cal.App.3d 927, 262 Cal.Rptr. 260 (1989) 20

Solem v. Helm, 463 U.S. 277 (1983) 23

Southwestern Tel. Co. v. Danaher, 238 U.S. 482 (1915) 22

St. Louis, I. Mt. & So. Ry. Co. v. Williams, 251 U.S. 63 (1919) 11, 13, 21, 23

Toole v. Richardson-Merrell Inc., 251 Cal.App.2d 689, 60 Cal.Rptr. 398 (1967) 12

United States v. Batchelder, 442 U.S. 114 (1979) 11, 12, 18, 25

Walker v. Signal Companies, Inc., 84 Cal.App.3d 982, 149 Cal.Rptr. 119 (1978) 20

Waters-Pierce Oil Co. v. Texas, 212 U.S. 86 (1909) 21, 23

Werschkull v. United California Bank, 85 Cal.App.3d 981, 149 Cal.Rptr. 829 (1978) 17

Zhadan v. Downtown Los Angeles Motor Distributors, Inc., 100 Cal.App.3d 821, 161 Cal.Rptr. 225 (1979) 12, 16

Constitutions

United States Constitution

Fifth Amendment 23

Eighth Amendment 23

Fourteenth Amendment ..... passim

TABLE OF AUTHORITIES

Statutes and Codes

Page

United States Code

Title 28, section 1257(a) 2

Title 28, section 2101(c) 2

California Business and Professions Code

Section 16750(a) 24

California Civil Code

Section 1747.60 24

Section 3294 ..... 13, 14

California Code of Civil Procedure

Section 735 24

Section 1029.8 24

California Health & Safety Code

Section 42402.2 ..... 24, 25

Rules and Regulations

Supreme Court Rules

Rule 13.1 2

Rule 46 24

California Rules of Court

Rule 5.1 3

Rule 10(d) 27

Rule 977 8

TABLE OF AUTHORITIES

Other Authorities

Page

California Book of Approved Jury Instructions No. 14.71 (1989 rev.) 15

Comment, Punitive Damage: The Burden of Proof Required by Fundamental Fairness, 22 U.S.F. L.Rev. 99 (1987) 10

Demarest & Jones, Exemplary Damages as an Instrument of Social Policy: Is Tort Reform in the Public Interest?, 18 St. Mary's L.J. 797 (1987) 19

Dobbs, Handbook on the Law of Remedies (1973) .. 16

Ellis, Fairness and Efficiency in the Law of Punitive Damages, 56 So.Cal.L.Rev. 1 (1982) 10, 17

Hensler, Vaiana, Kaklik & Peterson, Trends in Tort Litigation: The Story Behind the Statistics (1987) 10

Jeffries, A Comment on the Constitutionality of Punitive Damages, 72 Va.L.Rev. 139 (1986) 9-10, 22

Owen, Problems in Assessing Punitive Damages Against Manufacturers of Defective Products, 49 U.Chi.L.Rev. 1 (1982) 9

Wheeler, The Constitutional Case for Reforming Punitive Damages Procedures, 69 Va.L.Rev. 269 (1983) 9, 19

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STEVEN K. HILGEDICK, et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, FIRST APPELLATE DISTRICT

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the California Court of Appeal, First Appellate District, filed August 30, 1990, as amended October 1, 1990.

OPINION AND ORDERS BELOW

The opinion of the California Court of Appeal was ordered by that court not to be published, and is reproduced in Appendix A, *infra*. That court's order denying rehearing and amending its opinion is unreported and is reproduced in Appendix B, *infra*. The November 15, 1990 order of the Supreme Court of California denying discretionary review is unreported and is reproduced in Appendix C, *infra*. The Tentative Decision filed by the trial judge after the first trial is reproduced in Appendix D, *infra*. The trial judge's Statement of Reasons for granting in part petitioners' motion for new trial after the first trial is reproduced in Appendix E, *infra*. The trial court's order setting forth its rationale for

conditionally granting a new trial following the second trial is reproduced in Appendix F, *infra*.

JURISDICTION

The opinion and judgment of the California Court of Appeal was entered on August 30, 1990. In that opinion, the court rejected petitioners' constitutional challenges to California's punitive damages scheme. On October 30, 1990, the California Court of Appeal denied petitioners' timely petition for rehearing and made a modification of its opinion not relevant to the issues raised by petitioners in this Court. On November 15, 1990, the Supreme Court of California declined to grant discretionary review in this case. This petition was timely filed within 90 days of that date. 28 U.S.C. § 2101(c); Sup.Ct.R. 13.1. The jurisdiction of this Court to review the judgment of the California Court of Appeal by writ of certiorari is conferred by 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISION INVOLVED

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides, in pertinent part:

> "[N]or shall any state deprive any person of * * * property, without due process of law * * *."

STATEMENT OF THE CASE

This case involves an $8.5 million punitive damages award that was assessed against petitioners for "interfering" with respondents' business relations with a third party by exercising rights granted by their own contracts with respondents and the third party. The vague and open-ended nature of California's punitive damages scheme, which gives juries discretion to inflict punishment on tort defendants in virtually limitless amounts, and the magnitude of the enormous sanction imposed in this case, raise important constitutional questions that are virtually identical to those currently pending before this Court in *Pacific Mutual Life Insurance Co. v. Haslip* (Docket No. 89-1279), certiorari

granted, 110 S.Ct. 1780 (1990) (argued October 3, 1990).[1] The petition also presents the question whether the principle of fair warning embodied in the Due Process Clause of the Fourteenth Amendment prohibits states from imposing tort liability for conduct permitted by valid and lawful contracts between the parties, where the state law in effect when the conduct occurred gave no warning that such conduct was prohibited.

A. The Parties.

Petitioner Koehring Finance Corporation was formerly engaged in financing the purchase by independent distributors of heavy construction equipment manufactured by petitioner Koehring Company. RT I 291; RT II 68, 1578-1579.[2] Respondent Steven Hilgedick was the president and owner of a controlling interest in Pacific Trencher & Equipment, Inc. ("Pacific Trencher"), not a party to this case, which distributed construction equipment for petitioner Koehring Company. RT I 48, 67-68; RT II 720-723, 829. Mr. Hilgedick also owned a controlling interest in Pacific Manufacturing Company ("Pacific Manufacturing"), which manufactured construction equipment for sale to Pacific Trencher and others, and he did business as Hilgedick Rental Company ("Hilgedick Rental"), which rented equipment to Pacific

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[1]Similar constitutional challenges to punitive damages regimes that allow juries unbridled discretion to inflict such damages are also before this Court in *Pacific Lighting Corporation v. MGW, Inc.* (Cal.App. 1990), certiorari pending (No. 90-626); *Eichenseer v. Reserve Life Ins. Co.*, 881 F.2d 1355 (5th Cir. 1989), certiorari pending (No. 89-1303); *Hospital Authority of Gwinnett County v. Jones*, 386 S.E.2d 120 (Ga. 1989), certiorari pending (No. 89-1315); *Land Associates v. Simmons*, 562 So.2d 140 (Ala. 1989), certiorari pending (No. 90-73); and *Massachusetts Mutual Life Insurance Co. v. Collins*, No. 88-949 (Ala. 1990), certiorari pending (No. 90-244).

[2]The clerk's transcript and reporter's transcript from the first trial, and the reporter's transcript from the second trial, are cited as "CT," "RT I," and "RT II," respectively. The three-volume joint appendix filed in lieu of a clerk's transcript for the second trial (see Cal.Rules of Court, Rule 5.1) is cited as "__ Appx."

Trencher. RT I 29; RT II 67, 707, 786.[3] Each of the alleged acts of tortious interference that served as the basis of the enormous punitive damages award in this case involved business dealings between these interrelated companies.

B. Statement of Facts.

During 1979, Pacific Trencher began to experience financial problems. By early 1980, Pacific Trencher's line of credit with its primary lender had been canceled, and the company was having difficulty meeting its payroll. RT I 116, 117, 130; RT II 791, 797-798, 1147. Soon, Pacific Trencher's financial condition had deteriorated to the point that no bank would lend it money. RT II 799-800, 1150-1151.

Petitioners, who were interested in preserving the commercial viability of their only California distributor, agreed to loan Pacific Trencher $1 million. Appx. 225-241; RT II 821. As part of the loan agreement, respondents entered into written guarantees of Pacific Trencher's obligations to petitioners. CT 129-146. Mr. Hilgedick's guarantee was secured by the assignment and pledge of his Pacific Trencher stock. CT 147-153. Mr. Hilgedick and Pacific Trencher also granted petitioners other rights. In this regard, Mr. Hilgedick agreed that Pacific Trencher's present and future debts to him would not be paid until its debts to petitioners were paid, and he assigned to petitioners, *inter alia*, "all of his present and future accounts, contract rights, general intangibles, and all claims of any nature" against Pacific Trencher. Pl.Exh. 22, Tab 9, Def.Exh. 528; 2 Appx. 250.[4] In addition, Mr. Hilgedick

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[3]For economy of expression, Koehring Finance Corporation and Koehring Company are hereinafter referred to as "petitioners," and Mr. Hilgedick, Pacific Manufacturing and Hilgedick Rental are hereinafter referred to as "respondents," unless differentiation among the parties is relevant to the discussion.

[4]All exhibits cited herein are from the first trial. The same documents were also admitted into evidence at the second trial, and they are reproduced in the joint appendix filed in lieu of a clerk's transcript. Citation to exhibits from the second trial is therefore made to the place at which they appear in the joint appendix.

assigned to petitioners "all rents and other sums due and to become due" from Pacific Trencher under that company's lease of its premises, which he owned. Pl.Exh. 22, Tab 12; 2 Appx. 255. Finally, Pacific Trencher agreed that it would not guarantee the obligation of any other company without petitioners' permission. Pl.Exh. 22, Tab 1, p. 7, ¶ 6.8; Def.Exh. 523, p. 7, ¶ 6.8; 2 Appx. 225, 231.

By September 1980, Pacific Trencher was delinquent on its debt to petitioners. RT I 176; RT II 842-843, 846. The following month, petitioners, in accord with the rights granted under the loan documents, declared Pacific Trencher to be in default on its debt and assumed control over Mr. Hilgedick's Pacific Trencher stock. CT 603, 831.[5]

Thereafter, Mr. Hilgedick, both individually and through the entities he controlled, demanded payment from Pacific Trencher for construction equipment leased or sold to Pacific Trencher by those entities. Mr. Hilgedick also demanded that Pacific Trencher pay him the $7,000 monthly rental for the use of the premises that he leased to Pacific Trencher. In addition, Mr. Hilgedick requested that Pacific Trencher guarantee performance of a government contract on which Pacific Manufacturing had submitted a bid. RT I 193, 203, 280, 361; RT II 874, 875, 1657, 1665. Petitioners, who believed that respondents were not entitled to such payments and guarantee under the express terms of the loan documents executed by the parties, rejected these demands and requests. RT I 193-194, 202, 211, 346-347, 361; RT II 875, 1652-1655, 1657-1658, 1660, 1666-1667.

In March 1981, petitioners received fully audited financial statements prepared by Pacific Trencher's outside accountants, which showed that the company had lost a substantial amount of money during the 1979-1980 fiscal year and that its liabilities significantly exceeded its assets. 2 Appx. 265-267. Petitioners then advised Pacific Trencher's other shareholders of their opinion that the company could not survive, and they recommended

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[5]The legality of petitioners' assumption of control over Pacific Trencher has never been challenged. See App. D, *infra*, pp. 1-11, 14.

that it be dissolved. RT II 1702. Pacific Trencher thereafter petitioned for relief in the bankruptcy court.

C. The Proceedings Below.

The first trial: In November 1981, respondents filed the present action for, *inter alia*, tortious interference with contractual relations and prospective economic advantage. The acts of alleged tortious interference were based on petitioners' refusal to allow Pacific Trencher to (a) pay Mr. Hilgedick and Pacific Manufacturing for construction equipment leased or sold to Pacific Trencher, (b) pay rent for the premises leased from Mr. Hilgedick, and (c) guarantee Pacific Manufacturing's performance of the government contract. CT 18-19, 733-734. Respondents also sought a declaration that Pacific Trencher's debt to petitioners had been "extinguished" by, *inter alia*, petitioners' alleged bad faith mismanagement of Pacific Trencher. CT 2-10.

The tortious interference claims were tried to a jury, which awarded respondents $730,482.10 in compensatory damages and an equal amount in punitive damages. CT 959-960.[6] By stipulation, respondents' other causes of action were submitted to the trial court, which found that petitioners had *not* acted in bad faith in their management of Pacific Trencher, and that the security documents executed by respondents in connection with the loan were valid and enforceable against them in the amount of $1,986,025. App. D, *infra*, pp. 1-2, 5-9, 14.[7]

Petitioners moved for judgment notwithstanding the adverse jury verdicts and for a new trial. The trial judge denied the

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[6]The compensatory damages were allocated among respondents as follows: $42,000 to Mr. Hilgedick, $261,682.10 to Hilgedick Rental, and $426,800 to Pacific Manufacturing. CT 959. The punitive damages awarded to each respondent equaled each compensatory award. CT 960.

[7]The California Court of Appeal affirmed the trial court's rulings that petitioners had not acted in bad faith and that the loan documents were valid and enforceable against respondents, but reversed the portion of the judgment that awarded petitioners damages on the ground that the amount of respondents' obligation had not been "put in issue" as a matter of state law. App. A, *infra*, pp. 18-23.

motions insofar as they pertained to the award of compensatory damages. App. E, *infra*, p. 1. However, the judge found no substantial evidence of malice or oppression, and he granted a new trial limited to the question of punitive damages. App. E, *infra*, pp. 1-4; CT 974, 977.

The second trial: In 1987, the issue of punitive damages was tried to a second jury before a new trial judge. That jury awarded respondents $11 million in punitive damages, apportioned as follows: $5 million to Mr. Hilgedick, $5 million to Pacific Manufacturing and $1 million to Hilgedick Rental. 3 Appx. 112. The $5 million award to Mr. Hilgedick was remitted to $2.5 million on petitioners' motion for a new trial, reducing the total punitive damages award to $8.5 million. 3 Appx. 348, 360-362; App. F, *infra*.[8]

D. Presentation and Decision of the Federal Constitutional Questions.

In the California Court of Appeal, petitioners argued, *inter alia*, that California's punitive damages scheme violates the Due Process Clauses of the California and United States Constitutions by giving juries " 'wholly standardless discretion' " to inflict "enormous punitive sanctions" on an ad hoc basis. App.Opn.Br.,

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[8]The amount of punitive damages assessed against petitioners is in fact considerably larger than $8.5 million because of an unusual "additur" provision that the second trial judge included in the judgment. This extraordinary provision added to the punitive damages award "any amount recovered by [petitioners]" in Mr. Hilgedick's federal bankruptcy proceeding (*In re Steven Hilgedick*, Bankr.Ct. N.D.Cal., No. 4-83-02174-H) "to the extent [petitioners'] recovery in that proceeding comes from funds that would not have existed [in Mr. Hilgedick's bankruptcy estate] but for the award of exemplary damages in this judgment." App. A, *infra*, p.3; 3 Appx. 114.

Petitioners have commenced an adversary proceeding in federal bankruptcy court to recover the amount of respondents' obligation under the loan documents, which the California courts have already determined to be valid and enforceable. Petitioners estimate that this sum is in excess of $2 million.

p. 31, n. 13.[9] On August 30, 1990, in an opinion ordered not to be published pursuant to Rule 977 of the California Rules of Court, the California Court of Appeal rejected petitioners' arguments and affirmed the awards of compensatory and punitive damages. App. A, *infra*, pp. 9-18, 31-43. The court held that, in view of "the long line" of appellate decisions in California that have rejected constitutional challenges to punitive damages, it was "compelled by stare decisis to uphold the continuing constitutional validity" of California's punitive damages scheme. App. A, *infra*, p. 42; *see id.* at 39-43. The Court of Appeal denied rehearing. App. B, *infra*.

Petitioners petitioned the California Supreme Court for review. There, petitioners renewed their constitutional challenges to California's punitive damages scheme and to the enormous punitive

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[9]Petitioners challenged California's punitive damages system on the grounds that it violates both the Due Process and Excessive Fines Clauses of the United States and California Constitutions. App.Opn.Br., pp. 31-32, 43-44, nn. 13, 18. Petitioners also joined in the constitutional arguments made in a 32-page *amicus curiae* brief filed on petitioners' behalf by the Northern California Association of Defense Counsel. App.Reply Br., p. 25.

Although petitioners did not advance their due process arguments in the trial court, it would have been an idle act to have done so since the California Supreme Court and Courts of Appeal have uniformly rejected such challenges. *See, e.g., Bertero v. National General Corp.*, 13 Cal.3d 43, 66, n. 13, 118 Cal.Rptr. 184, 529 P.2d 608 (1974); *Grimshaw v. Ford Motor Co.*, 119 Cal.App.3d 757, 811, 174 Cal.Rptr. 348 (1981). Under these circumstances, petitioners were not required to raise these challenges in the trial court as a matter of state law. *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 46 Cal.3d 287, 292, n. 1, 250 Cal.Rptr. 116, 758 P.2d 58 (1988) (defendant was not required to raise the issue in the lower courts because "clearly it was pointless for defendant to ask either the trial or appellate court to overrule one of our decisions"); *see generally Auto Equity Sales v. Superior Court*, 57 Cal.2d 450, 455, 20 Cal.Rptr. 321, 369 P.2d 937 (1962) (decisions of higher courts are binding upon and must be followed by courts exercising inferior jurisdiction).

sanction imposed in this case.[10] Petitioners also requested that the court, in the event that it declined to reach the merits of the questions raised in their petition for review, hold the case until this Court decided *Pacific Mutual Life Insurance Co. v. Haslip, supra*, which presents virtually identical constitutional questions. On November 15, 1990, the Supreme Court of California, without opinion, denied review. App. C, *infra*.[11]

REASONS FOR GRANTING THE WRIT

The recent "explosion" in the incidence and size of punitive damages awards, and their destructive impact on the economic stability of business and industry, has been documented by numerous courts and commentators.[12] In California, multimillion

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[10]In their petition for review, petitioners asked the California Supreme Court to review, *inter alia*, the following questions:

> "5. Does California's punitive damage scheme violate the Due Process Clauses of the United States and California Constitutions by permitting the imposition of punitive damages in arbitrary and unpredictable amounts, thereby failing to provide defendants with fair warning of the penal consequences of their conduct?
>
> "6. Do the Due Process Clauses of the California and United States Constitutions place an outer limit on awards of punitive damages that are grossly disproportionate to the harm caused and far in excess of any amount necessary to punish and deter?" Pet.Rev., pp. 1-2.

[11]On December 17, 1990, Justice O'Connor granted petitioners' application for a stay pending the filing and disposition of this petition (No. A-459). On January 7, 1991, this Court denied respondents' motion to vacate the stay.

[12]*See, e.g., Browning-Ferris Industries v. Kelco Disposal, Inc.*, ___ U.S. ___, 109 S.Ct. 2909, 2924 (1989) (O'Connor, J., concurring and dissenting); *Rosener v. Sears, Roebuck & Co.*, 110 Cal.App.3d 740, 758, 168 Cal.Rptr. 237 (1980) (Elkington, J., concurring); Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va.L.Rev. 269, 271 & n. 6 (1983); Owen, *Problems in Assessing Punitive Damages Against Manufacturers of Defective Products*, 49 U.Chi.L.Rev. 1, 3-6 (1982); Jeffries, *A Comment on the Constitutional-*

dollar awards of punitive damages have become almost commonplace, leading one California jurist to conclude that "the law of punitive damages as it has developed in this state no longer serves any public policy, or the legitimate interests of the unentitled recipients of its constantly accelerating largess." *Rosener v. Sears, Roebuck & Co.*, 110 Cal.App.3d 740, 758, 168 Cal.Rptr. 237 (1980) (Elkington, J., concurring).

California's punitive damages scheme accords juries unbridled discretion to inflict punitive damages in virtually limitless amounts. Juries are given no meaningful objective standards to apply in determining the amount of such damages, but rather "are free to base their decisions on preexisting biases or redistributional inclinations, subject only to the uncertain constraint of judicial review." Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 So.Cal.L.Rev. 1, 56 (1982) (footnote omitted). As a result, punitive damages are frequently imposed, as they were in this case, in "wholly unpredictable amounts bearing no necessary relation to the actual harm caused." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974); *see also Int'l Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 50 (1979). The lack of objective criteria for determining the amount of punitive damages, and the absence of statutory or common law limits on the size of such awards, deprives tort defendants of advance notice of the penal consequences of their conduct, contrary to the Due Process Clause of the Fourteenth Amendment.

The present case is illustrative of the unpredictability and uncertainty that characterizes California's standardless system of civil punishment: the first jury awarded respondents $730,482.10 in punitive damages; the judge who presided over the first trial

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ity of Punitive Damages, 72 Va.L.Rev. 139-145 (1986); Comment, *Punitive Damages: The Burden of Proof Required by Procedural Due Process*, 22 U.S.F.L.Rev. 99, 100-112 (1987); *see also* Hensler, Vaiana, Kaklik & Peterson, *Trends in Tort Litigation: The Story Behind the Statistics* at 18 (1987) (noting that the growth in the average award of punitive damages in products liability and mass tort litigation "has been truly explosive, reflecting increases ranging from 200 to more than 1000 percent" from the period 1960-1964 to 1980-1984).

ruled that the evidence did *not* support *any* punitive damages; however, a retrial before a different jury resulted in an award of $11 million in punitive damages, which was remitted to $8.5 million by a different trial judge. Incredibly, this huge penalty was assessed against petitioners on the basis of conduct that, on its face, was permitted by the express terms of the parties' contractual arrangements. Nothing in California law warned petitioners that actions in accord with their valid and lawful contracts would subject them to tort liability, let alone a staggering $8.5 million civil fine. This result simply cannot be squared with the constitutional mandate that laws provide fair warning of the conduct that is proscribed and the amount of punishment that can be imposed. *See United States v. Batchelder*, 442 U.S. 114, 123 (1979); *Giaccio v. Pennsylvania*, 382 U.S. 399, 402-403 (1966); *Bouie v. City of Columbia*, 378 U.S. 347, 352 (1964).

Moreover, the sheer magnitude of the punitive award imposed in this case itself implicates due process concerns. This Court's past precedents strongly suggest that the Due Process Clause of the Fourteenth Amendment places substantive limits on the amount of punitive damages that may be awarded by juries in civil cases. *See, e.g., St. Louis, I. Mt. & So. Ry. Co. v. Williams*, 251 U.S. 63, 66-67 (1919); *Missouri Pacific Ry. Co. v. Tucker*, 230 U.S. 340, 351 (1913). The sanction assessed against petitioners greatly exceeds these constitutional constraints. When viewed against the gravity of the conduct for which petitioners were punished, the $8.5 million award is grotesquely excessive. This onerous fine, which is over 11 times larger than the amount of compensatory damages and constitutes almost 6% of petitioners' combined net worth, far exceeds any amount necessary to advance the interests in retribution and deterrence served by California's punitive damages scheme. In short, it is excessive as a matter of substantive due process and must therefore be reversed.

Only this Court can resolve the important questions raised by this petition. California appellate courts have consistently rejected federal and state constitutional challenges to that State's punitive

damages system.[13] And, as in this case, courts frequently affirm the enormous windfall recoveries that result under that system in "unpublished" or "depublished" opinions that shield from public scrutiny the ad hoc and unpredictable nature of such awards. Guidance from this Court is therefore needed to establish meaningful standards for juries to follow "in making this important, and potentially devastating, decision." *Browning-Ferris Industries v. Kelco Disposal, Inc.*, __ U.S. __, 109 S.Ct. 2909, 2923 (1989) (Brennan, J., concurring).

ARGUMENT

I.

CALIFORNIA'S PUNITIVE DAMAGES SCHEME, WHICH ALLOWS JURIES ESSENTIALLY UNFETTERED DISCRETION TO INFLICT PUNISHMENT IN VIRTUALLY UNLIMITED AMOUNTS, VIOLATES THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

A. Statutes Authorizing the Imposition of Punitive Damages Are Subject to the Due Process Proscription Against Vague Laws.

The Due Process Clause of the Fourteenth Amendment requires that laws give fair warning of proscribed conduct and the punishment that may be imposed. *United States v. Batchelder*, 442 U.S. 114, 123 (1979). The reasons for this requirement are twofold: First, laws must "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Grayned v. City of Rockford*, 408 U.S. 104,

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[13] *E.g., Hasson v. Ford Motor Co.*, 32 Cal.3d 388, 402, n. 2, 185 Cal.Rptr. 654, 650 P.2d 1171 (1982); *Bertero v. National General Corp., supra*, 13 Cal.3d at 66, n. 13; *People ex rel. Dept. of Transportation v. Grocers Wholesale Co.*, 214 Cal.App.3d 498, 514, 262 Cal.Rptr. 689 (1989); *Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co.*, 189 Cal.App.3d 1072, 1101, 234 Cal.Rptr. 835 (1987), certiorari denied, 486 U.S. 1036 (1988); *Zhadan v. Downtown L.A. Motors*, 66 Cal.App.3d 481, 501-502, 136 Cal.Rptr. 132 (1976); *Toole v. Richardson-Merrell Inc.*, 251 Cal.App.2d 689, 716, 60 Cal.Rptr. 398 (1967).

108 (1972); *Papachristou v. City of Jacksonville*, 405 U.S. 156, 162 (1972). Second, laws must "provide explicit standards for those who apply them" so as to discourage their arbitrary and discriminatory application. *Grayned v. City of Rockford, supra*, 408 U.S. at 108-109; *Giaccio v. Pennsylvania*, 382 U.S. 399, 402-403 (1966); see *Kolender v. Lawson*, 461 U.S. 352, 357-358 (1983) (noting that the need to inhibit arbitary and capricious imposition of punishment is "the more important aspect of the vagueness doctrine").

In California, as in the vast majority of states, punitive damages are penal both in purpose and effect:

> "[P]unitive damages serve but one purpose — to punish and through punishment, to deter. 'Punitive damages by definition are not intended to compensate the injured party, but rather to punish the tortfeasor whose wrongful action was intentional or malicious, and to deter him and others from similar extreme conduct.' " *Dyna-Med, Inc. v. Fair Employment and Housing Com.*, 43 Cal.3d 1379, 1387, 241 Cal.Rptr. 67, 743 P.2d 1323 (1987) quoting *City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 266-267 (1981); Cal.Civ.Code § 3294 (punitive damages are assessed "for the sake of example and by way of punishing the defendant").

That punitive damages are imposed in nominally civil actions does not insulate them from scrutiny under the Due Process Clause; nor is it relevant to due process analysis that such damages are paid to private litigants rather than to the state. On the contrary, as this Court has made clear on numerous occasions, the requirement of due process applies to any adjudicatory proceeding that may result in deprivation of life, liberty or property, regardless of whether it be labeled "civil" or "criminal."[14] Hence,

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[14]*See, e.g., City of Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283, 289-291 (1982) (civil municipal licensing requirements reviewed under void-for-vagueness doctrine); *Giaccio v. Pennsylvania*, 382 U.S. 399, 402-404 (1966) (civil statute that allowed jury to impose prosecution costs on an acquitted defendant without prescribing definite standards to govern jury's determination held unconstitutionally vague); *St. Louis, I. Mt. & So. Ry. Co. v. Williams*, 251 U.S. 63, 66 (1919) (Fourteenth

to pass constitutional muster, the standards for imposing punitive damages must be sufficiently definite, both as to the type of conduct that is sanctionable and as to the amount of punishment that can be imposed.

B. California Law Provides No Meaningful Objective Standards for Juries to Follow in Setting the Amount of Punitive Damages Awards. As a Result, Defendants Have No Advance Notice of the Amount of Punishment That May Be Imposed.

In California, punitive damages are authorized by statute. Cal.Civ.Code § 3294. This statute places no limit on the amount of punitive damages that may be imposed, nor does it provide any meaningful objective criteria for determining how large an award is necessary to serve the statute's twin goals of retribution and deterrence. [15] As a result, juries are left to inflict such awards, in potentially limitless amounts, on the basis of their own personal predilections. As one California court has observed:

Amendment places limitation on states to prescribe penalties, even where the penalty is enforced by a private action and goes to the plaintiff rather than to the state).

[15] At the time of trial, section 3294(a) provided:

> "In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant."

Effective January 1, 1988, section 3294 was amended. Stats. 1987, ch. 1498, § 5. The amendments redefined "malice" and "oppression", and elevated the burden of proof necessary to support a claim for punitive damages by requiring "clear and convincing evidence" of oppression, fraud or malice. Despite the amendments, California's punitive damages regime remains constitutionally flawed. The amendments pertain only to the jury's initial determination whether *any* punitive damages are warranted; they do nothing to limit the jury's discretion to determine the *size* of such an award.

> "The channeling of just the correct quantum of bile to reach the correct level of punitive damages is, to put it mildly, an unscientific process complicated by personality differences. Conduct which one person may view as outrageous another may accept without feeling, depending on such diverse characteristics as an individual's background, temperament and societal concerns. The process is further complicated by the lack of objective criteria from either the Legislature or the courts as to 'how much' is necessary to punish and deter." *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc.*, 155 Cal.App.3d 381, 388, 202 Cal.Rptr. 204 (1984).

The standard California jury instruction on punitive damages, given in this case, does little to channel the jury's discretion in determining the magnitude of punitive damage assessments. Indeed, the instruction informs jurors at the outset that their discretion to sanction is subject to "no fixed standards," and that they are simply "to consider" three factors.[16] None of these factors provides realistic limits on the jury's power to punish.

The first factor — the "reprehensibility" of the defendant's conduct — is, as this Court has observed, too "loose and unlimiting" to provide an adequate benchmark for assessing how severely

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[16]The approved California jury instruction provides, in pertinent part:

> "*The law provides no fixed standards as to the amount of such punitive damages*, but leaves the amount to the jury's sound discretion, exercised without passion or prejudice.
>
> "In arriving at any award of punitive damages, you are to consider the following:
>
> "(1) The reprehensibility of the conduct of the defendant.
>
> "(2) The amount of punitive damages which will have a deterrent effect on the defendant in the light of defendant's financial condition.
>
> "(3) That the punitive damages must bear a reasonable relation to the injury, harm, or damage actually suffered by the plaintiff." California Book of Approved Jury Instructions (BAJI), No. 14.71 (1989 rev.) (emphasis added).

The version of the instruction given at petitioners' trial contained virtually identical language. RT II 2075.

to sanction a defendant. *Giaccio v. Pennsylvania, supra*, 382 U.S. at 403-404. Juries are not told what conduct the law considers "reprehensible," but rather are left to apply their own subjective standards, thereby creating the risk that punitive damages will be used to punish unpopular defendants. *See Int'l Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 50-51, n. 14 (1979); *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974).

Nor does the second factor — the defendant's financial condition — provide an adequate check on jury discretion. Even a cursory review of the widely divergent results reached by California appellate courts on this issue demonstrates the need for objective standards for determining the proper relationship between punitive damages and the defendant's wealth.[17]

The requirement that the punitive award must bear a "reasonable relation" to the amount of actual damages also does little to channel the jury's discretion. Jurors are given no frame of reference for determining "reasonableness" and instead are left to make this determination on the basis of their own idiosyncratic notions of what is "reasonable." Unlike other standards that use "reasonableness" as a measure (*e.g.*, the "reasonable person" standard in negligence cases), there is nothing in the common experience of most jurors that would allow them to determine whether the ratio of punitive to compensatory damages is "reasonable" in any given case. Moreover, the "reasonable relation" requirement is inherently inconsistent with the requirement that punitive damages be proportioned to the defendant's ability to pay them; the smaller the actual damages and the greater the defendant's wealth, the more difficult it becomes to reconcile these two requirements. See Dobbs, *Handbook on the Law of Remedies* § 3.9, pp. 210-211 (1973) (noting the "direct conflict" between these requirements).

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[17] *See, e.g., Zhadan v. Downtown Los Angeles Motor Distributors, Inc.*, 100 Cal.App.3d 821, 836, 161 Cal.Rptr. 225 (1979) (upholding award of punitive damages totaling almost 7% of defendant's net worth); *Rosener v. Sears, Roebuck & Co.*, 110 Cal.App.3d 740, 750, 168 Cal.Rptr. 237 (1980) (award of punitive damages amounting to one-fourth of 1% of defendant's net assets struck down as excessive).

Nor have the California appellate courts been helpful in formulating criteria for determining whether a particular ratio of punitive to compensatory damages is reasonable. Indeed, in cases too numerous to cite, it is repeatedly emphasized that "[t]here is no fixed ratio" by which to determine a proper proportion between the two classes of damages. *E.g., Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co.*, 189 Cal.App.3d 1072, 1097, 234 Cal.Rptr. 835 (1987), certiorari denied, 486 U.S. 1036 (1988). For this reason, one commentator has observed that the "reasonable relation" test is virtually useless as a tool for controlling jury discretion:

> "[T]he reasonable relationship principle . . . neither provides meaningful guidance to decisionmakers nor increases certainty. This is so because the principle does not imply a 'mathematical ratio.' As a result, there are enormous variations in the ratio of punitive to compensatory damages. The 'principle' thus is vacuous. It provides no rational basis for deciding whether the size of a punitive damage assessment is appropriate." Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 So.Cal.L.Rev. 1, 60 (1982) (footnotes omitted).[18]

As a result of the virtually limitless discretion juries enjoy in determining the amount of punitive damages, defendants have no advance notice of the amount of punishment that may be imposed for a given course of conduct. Punishment on such an ad hoc, after-the-fact basis simply cannot be squared with the notion of

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[18]This observation is borne out by the inconsistency in the manner in which California courts have applied this factor in determining whether an award of punitive damages is excessive. Compare *Finney v. Lockhart*, 35 Cal.2d 161, 163, 217 P.2d 19 (1950) (2,000:1 ratio between punitive and actual damages upheld) and *Werschkull v. United California Bank*, 85 Cal.App.3d 981, 992, 1004-1005, 149 Cal.Rptr. 829 (1978) (550,000:1 ratio between punitive and actual damages upheld) with *Little v. Stuyvesant Life Ins. Co.*, 67 Cal.App.3d 451, 469-470, 136 Cal.Rptr. 653 (1977) (14:1 ratio between punitive and compensatory damages held excessive) and *Allard v. Church of Scientology*, 58 Cal.App.3d 439, 453, 129 Cal.Rptr. 797 (1976) (5:1 ratio between punitive and actual damages held excessive).

"fundamental fairness" that lies at the heart of due process. As Justice O'Connor recently observed:

> "[The] grant of wholly standardless discretion to determine the severity of punishment appears inconsistent with due process . . . Nothing in [the state's] law warned appellant that by committing a tort that caused $20,000 of actual damages, it could expect to incur a $1.6 million punitive damages award." *Bankers Life & Casualty Co. v. Crenshaw*, 486 U.S. 71, 88 (1988) (O'Connor, J., concurring) (citations omitted).

The situation is even more aggravated here. Petitioners were not only subjected to tort liability, but also were burdened with an enormous $8.5 million civil fine, for exercising rights that clearly appeared to be granted to them by express provisions in their contracts with respondents and Pacific Trencher. For example, the jury awarded Mr. Hilgedick $5 million in punitive damages (remitted to $2.5 million) to punish petitioners for directing Pacific Trencher to withhold rental payments totaling $42,000 that were owed to Mr. Hilgedick. Yet, one of the loan documents contained an assignment to petitioners of all of Mr. Hilgedick's "present and future accounts, contract rights . . ., and all claims of any nature" against Pacific Trencher (Pl.Exh. 22, Tab 9, Def.Exh. 528; 2 Appx. 250), and another expressly gave petitioners the right to collect all rents due from Pacific Trencher to Mr. Hilgedick, and to apply such sums against Pacific Trencher's indebtedness to petitioners. Pl. Exh. 22, Tab 12; 2 Appx. 255-256.

Assuming solely for purposes of argument that it is constitutionally permissible to impose tort liability in these circumstances (which, petitioners submit, it is not; *see infra*, pp. 25-29), it is nonetheless a blatant violation of due process to deprive a defendant of notice of the amount of punishment that may be imposed, as occurred here. Just as this Court would not tolerate a criminal statute that gave a judge or jury unbridled discretion to impose punishment without providing advance notice of the range of penalties that could be imposed (*see, e.g., United States v. Batchelder, supra*, 442 U.S. at 123), neither should it tolerate a civil statute that allows the imposition of potentially limitless fines without warning.

C. The Availability of Appellate Review or the Potential for Remittitur Does Not Cure the Unconstitutionality of California's Punitive Damages Scheme.

Despite claims by proponents of punitive damages that existing "judicial controls provide sufficient procedural protection against excessive exemplary damage awards" (Demarest & Jones, *Exemplary Damages as an Instrument of Social Policy: Is Tort Reform in the Public Interest?*, 18 St. Mary's L.J. 797, 815-816 (1987) (footnote omitted)) post-verdict review is an inadequate safeguard against the arbitrary and unpredictable awards that result under California's standardless system of civil punishment. This is so for several reasons.

As an initial matter, post-verdict review does nothing to cure the threshold flaws in California's punitive damages scheme: standardless jury discretion and the concomitant lack of advance notice to defendants of the amount of punishment that may be inflicted. As this Court has recognized in other contexts, a procedure for review of a decision made under a vague statute does not, and cannot, cure the statute's unconstitutionality. *Baggett v. Bullitt*, 377 U.S. 360, 373 (1964); *Santosky v. Kramer*, 455 U.S. 745, 757 & n. 9 (1982).

Moreover, in reviewing an award of punitive damages, courts consider the same vague and contentless factors that juries apply in determining the amount of the award in the first place. *See Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., supra,* 155 Cal.App.3d at 387-388; *Rosener v. Sears Roebuck & Co., supra,* 110 Cal.App.3d at 750-752. Unless the standards applied by the jury are clear, no meaningful judicial review can be conducted. *Roberts v. United States Jaycees*, 468 U.S. 609, 629 (1984). As one commentator has aptly observed:

> "Because juries are not instructed to adhere to any ascertainable standard or to apply any specified set of factors, no appellate court can determine that the jury improperly applied or ignored any standard or set of factors." Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va.L.Rev. 269, 290 (1983).

Even if meaningful standards for reviewing punitive damages existed, the extreme reluctance of appellate courts to overturn

jury verdicts limits the courts' capacity to correct arbitrary and unpredictable awards. In California, as in many other states, an award of punitive damages is imbued with a presumption of correctness, and will be disturbed only when it is so excessive as to compel the conclusion that it resulted from passion or prejudice. *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., supra,* 155 Cal.App.3d at 388; *Walker v. Signal Companies, Inc.*, 84 Cal.App.3d 982, 997, 149 Cal.Rptr. 119 (1978). This extraordinarily deferential standard of review severely circumscribes the power of appellate courts to constrain improper awards. *See Ferraro v. Pacific Fin. Corp.*, 8 Cal.App.3d 339, 355, 87 Cal.Rptr. 226 (1970) (court expressed disapproval of punitive damages that "constitute[d] a windfall" to the plaintiff, but reluctantly concluded it was "bound" to affirm under the restrictive standard of review applicable to such awards).

Indeed, rather than act as a check on arbitrary and capricious awards, appellate review often serves merely to perpetuate the unpredictable and ad hoc nature of California's punitive damages scheme. Under California's system of appellate review, courts of appeal frequently affirm large awards of punitive damages in "unpublished" opinions, as occurred here, and thereby shield from public scrutiny the constitutional defects of the punitive damages system.[19]

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[19] *See, e.g., G. Amador Corp. v. The Ohio Casualty Insurance Co.*, petition for certiorari filed June 19, 1990, certiorari dismissed (No. 89-1986) (affirming $10,000,000 punitive damage award in an unpublished opinion); *Farajpour v. University of Southern California*, 221 Cal.App.3d 19, 39-40, 270 Cal.Rptr. 356 (1990) (affirming $800,001 punitive damage award in an opinion subsequently ordered depublished); *George v. International Society for Krishna Consciousness of California*, 213 Cal.App.3d 729, 798, 262 Cal.Rptr. 217 (1989) (affirming $2.5 million punitive damages award in an opinion subsequently ordered depublished), certiorari pending (No. 89-1399); *Security Pacific National Bank v. Williams*, 213 Cal.App.3d 927, 262 Cal.Rptr. 260 (1989) (affirming $2,500,000 punitive damage award in an opinion subsequently ordered not to be published); *Leonardini v. Shell Oil Co.*, 216 Cal.App.3d 547, 264 Cal.Rptr. 883 (1989) (affirming $5,000,000 punitive damage award; punitive damage portion of opinion ordered depublished), certiorari denied, 111 S.Ct. 293 (1990).

In sum, the system for imposing punitive damages in California, and perhaps in the majority of other states as well, is fundamentally flawed. Accordingly, petitioners urge this Court to declare that the standardless and ad hoc manner in which punitive damages are imposed in California does not comport with due process. California's courts or its legislature can then articulate narrowly drawn standards that clearly specify in what amounts punitive damages may be awarded.

II.

THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT PROHIBITS JURY AWARDS OF PUNITIVE DAMAGES IN AMOUNTS THAT ARE OPPRESSIVE AND BEAR NO REASONABLE RELATION TO THE INTERESTS IN RETRIBUTION AND DETERRENCE.

A. The Due Process Clause Places Outer Limits on the Amounts of Punitive Damages That Can Be Awarded by Juries in Civil Cases.

The Due Process Clause of the Fourteenth Amendment has long been recognized as encompassing a "substantive" component that bars arbitrary and oppressive government actions "regardless of the fairness of the procedures used to implement them." *Daniels v. Williams*, 474 U.S. 327, 331 (1986); see *Hurtado v. California*, 110 U.S. 516, 527 (1884). Under this doctrine, state action that is wholly arbitrary and irrational and bears no reasonable relation to the legitimate goals ostensibly served by that action will not survive due process scrutiny.

Almost a century ago, this Court recognized that these principles prohibited state courts from imposing civil penalties and other types of extra-compensatory damages that were "so severe and oppressive as to be wholly disproportioned to the offense and obviously unreasonable." *St. Louis, I. Mt. & So. Ry. Co. v. Williams*, 251 U.S. 63, 66-67 (1919); *see also Waters-Pierce Oil Co. v. Texas*, 212 U.S. 86, 111 (1909). Thus, in *Missouri Pacific Ry. Co. v. Tucker*, 230 U.S. 340 (1913), the Court struck down as constitutionally excessive an award of liquidated damages ren-

dered under a state statute that required common carriers to pay such damages to shippers whom they overcharged. In holding that the award could not stand, the Court declared that the award was "grossly out of proportion to the possible actual damages" and "so arbitrary and oppressive" as to be repugnant to the Fourteenth Amendment. *Id.* at 351; *see also Southwestern Tel. Co. v. Danaher*, 238 U.S. 482, 489-491 (1915).

These decisions provide ample support for the conclusion that the Fourteenth Amendment places outer limits on the size of punitive damages awards imposed by juries in civil cases. While this Court has yet to hold an award of punitive damages excessive as a matter of substantive due process, several members of the Court have recently intimated that huge punitive damages awards may implicate substantive due process principles. Thus, in his concurring opinion in *Browning-Ferris Industries v. Kelco Disposal, Inc.*, ___ U.S. ___, 109 S.Ct. 2909 (1989), Justice Brennan, joined by Justice Marshall, wrote:

> "Several of our decisions indicate that even where a statute sets a range of possible civil damages that may be awarded to a private litigant, the Due Process Clause forbids damages awards that are 'grossly excessive,' . . . or 'so severe and oppressive as to be wholly disproportioned to the offense and obviously unreasonable.' . . . I should think that, if anything, our scrutiny of awards made without the benefit of a legislature's deliberation and guidance would be less indulgent than our consideration of those that fall within statutory limits." 109 S.Ct. at 2923 (citations omitted); *see also, id.* at 2924 (O'Connor, Stevens, JJ., concurring) (inviting a "due process challenge to awards of punitive damages or the method by which they are imposed").[20]

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[20]Several commentators have also concluded that the Due Process Clause of the Fourteenth Amendment places limits on the amount of punitive damages that can be awarded in civil cases. *See, e.g.*, Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 Va.L.Rev. 139, 151-158 (1986) (concluding that the concept of proportionality of punishment is inherent in the requirement of "fundamental fairness"

B. The $8.5 Million Award of Punitive Damages Assessed Against Petitioners Is So Oppressive and Disproportionate to Petitioners' Culpability as to Render the Award Constitutionally Excessive.

Should this Court determine that substantive due process constraints on awards of punitive damages do indeed exist, it must then articulate standards to be applied in determining whether a particular award is constitutionally excessive. In the past, this Court has reviewed awards of extra-compensatory damages for excessiveness by evaluating whether the award rationally served the purposes of the regulatory scheme under which the award was imposed. *St. Louis, I. Mt. & So. Ry. Co. v. Williams*, supra, 251 U.S. at 67; *Waters-Pierce Oil Co. v. Texas, supra*, 212 U.S. at 111. The present inquiry into excessiveness should be similarly guided. Thus, an award of punitive damages that is larger than necessary to further the twin goals of retribution and deterrence that animate punitive damages doctrine serves no legitimate governmental interest and must be deemed constitutionally excessive.

An analysis of whether a punitive award serves the interest in punishment should reflect the law's concern that punishment not be disproportionately excessive in view of the defendant's culpability. In the criminal law context, this Court has articulated several factors, including the gravity of the offense and the penalties imposed for similar conduct, which are to be considered in determining whether punishment is disproportionate and hence unconstitutional under the Eighth Amendment. *See Solem v. Helm*, 463 U.S. 277 (1983). These factors are equally relevant in assessing a substantive due process challenge to a civil punitive damages award.

When measured against these standards, the huge penalty inflicted on petitioners is manifestly excessive. The remitted $8.5 million punitive damages award is larger than any award upheld

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mandated by the Fifth and Fourteenth Amendments, and prohibits multiple punitive recoveries for a single course of conduct).

in any reported decision in California.[21] This staggering penalty, which constitutes almost 6% of petitioners' combined net worth, was assessed against petitioners for engaging in conduct that, on its face, was permitted by the express terms of the parties' lawful and valid contracts and did not affect society at large.

Moreover, the sanction assessed against petitioners is disproportionately harsh in comparison to other civil penalties authorized by the California legislature. With regard to California statutes that impose a penalty that is a multiple of the underlying compensatory award, the maximum penalty of which petitioners are aware is three times actual damages.[22] With regard to California civil penalty statutes that impose a sanction "per violation," the largest such penalty of which petitioners have knowledge is $25,000 per day for willful failure to correct a condition causing air pollution. Cal.Health & Safety Code § 42402.2. By comparison, the remitted $8.5 million award assessed against petitioners is over *11 times* the amount of the compensatory damages awarded in this case, and is equivalent to the penalty that would be

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[21]The largest reported punitive damages award in California of which petitioners are aware is $5 million, which was assessed against an insurance company for engaging in invidious company-wide practices that violated its duty of good faith and fair dealing to a large number of policyholders. *Downey Savings & Loan Assn. v. Ohio Casualty Ins. Co., supra,* 189 Cal.App.3d 1072. In an unpublished opinion, the California Court of Appeal recently upheld a $10 million punitive damage award against the *same insurance company* for continuing to follow practices that encouraged the bad-faith denial of meritorious claims and the harassment of claimants. *G. Amador Corporation v. Ohio Casualty Insurance Company* (No. B029795, 12/29/89), petition for certiorari filed June 19, 1990 (No. 89-1986), certiorari dismissed pursuant to Supreme Court Rule 46, 111 S.Ct. 288 (1990).

[22] *See, e.g.*, Cal.Bus.& Prof.Code § 16750(a) (treble damages in antitrust actions under Cartwright Act); Cal.Civ.Code § 1747.60 (treble damages for willful failure to correct billing statement); Cal.Code Civ.Proc. § 1029.8 (treble damages, up to $10,000, against unlicensed person for injury caused by conduct for which a license is required); Cal.Code Civ.Proc. § 735 (treble damages for forcible or unlawful entry upon real property).

imposed for 440 violations of California Health and Safety Code section 42402.2, a statute designed to protect the health and welfare of the public at large.

Nor can an award of this size be justified as necessary to deter petitioners from engaging in similar conduct in the future. The $1 million loan that ultimately resulted in petitioners' lawful assumption of control over Pacific Trencher, from which all of the "tortious" conduct found by the first jury flowed, was an unprecedented transaction that had never occurred in the past and, since petitioners are no longer in the business that gave rise to the controversy, will not be repeated in the future. RT II 1623, 1730.

Thus, the $8.5 million penalty inflicted on petitioners bears no reasonable relation to any legitimate governmental interest in punishment and deterrence. Accordingly, it is constitutionally excessive and should therefore be reversed.

III.

ABSENT PRIOR NOTICE, THE IMPOSITION OF TORT LIABILITY AND PUNITIVE DAMAGES FOR CONDUCT ALLOWED BY VALID AND LAWFUL CONTRACTS VIOLATES THE PRINCIPLE OF FAIR WARNING EMBODIED IN THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

A. The Due Process Clause of the Fourteenth Amendment Guards Against the Imposition of Liability in the Absence of Advance Warning That Conduct Is Prohibited.

Before a defendant may be deprived of its liberty or property by the state, the defendant must be given notice of both the conduct that is proscribed and the punishment that may be assessed. *United States v. Batchelder*, 442 U.S. 114, 123 (1979); *Giaccio v. Pennsylvania*, 382 U.S. 399, 402-404 (1966). This concept of fair warning is not limited to legislative enactments. A due process violation can result not only from vague statutory language but also from an unforeseeable interpretation of the law by a court; in either case, the defendant is deprived of advance warning that its

conduct will subject it to liability. *Bouie v. City of Columbia*, 378 U.S. 347, 352, 354-355 (1964).

In the present case, the California judicial system ran roughshod over these principles. Petitioners were found liable in tort, and burdened with an enormous $8.5 million punitive damages award, for engaging in conduct that, on its face, was permitted by the express terms of the parties' contracts. At the time petitioners exercised these contract rights, California law afforded petitioners no warning that such conduct would expose them to liability. Under these circumstances, the imposition of tort liability, let alone the infliction of a multimillion dollar punitive damages award, simply cannot be squared with the principle of fair warning embodied in the Due Process Clause.

B. Petitioners Were Deprived of Fair Warning That Conduct in Accord With the Express Terms of Their Valid and Lawful Contracts Would Expose Them to Tort Liability.

After petitioners lawfully assumed control of Pacific Trencher, they withheld certain payments demanded by Mr. Hilgedick, including payments under Pacific Trencher's lease of its premises, and payments to Hilgedick Rental for construction equipment that it had provided to Pacific Trencher. In addition, petitioners refused Mr. Hilgedick's request that Pacific Trencher guarantee performance of a government contract upon which Pacific Manufacturing had submitted a bid. These actions were permitted by the express terms of petitioners' contracts with respondents and Pacific Trencher,[23] in which:

> (1) Mr. Hilgedick assigned to petitioners "*all* of his present and *future* accounts, *contract rights*, general intangibles, and *all* claims of *any* nature against [Pacific Trencher], together with the proceeds thereof" (Pl.Exh. 22, Tab 9, p. 1; 2 Appx. 250 (emphasis added));

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[23]Because Hilgedick Rental was not a legally separate entity, the contracts between petitioners and Mr. Hilgedick necessarily control with respect to both Mr. Hilgedick and Hilgedick Rental.

(2) Mr. Hilgedick agreed that he would not be paid any portion of the principal on present and future debts owed him by Pacific Trencher until all of Pacific Trencher's debts to petitioners were paid (Pl.Exh. 22, Tab 9; 2 Appx. 250-253; RT II 1180);

(3) Pacific Trencher agreed that it would not guarantee the obligation of any other company without first obtaining permission from petitioners (Pl.Exh. 22, Tab 1, p. 7, ¶ 6.8; 2 Appx. 231); and

(4) Mr. Hilgedick assigned to petitioners "all rents and other sums due and to become due" from Pacific Trencher under that company's lease of the premises it rented from Mr. Hilgedick, thereby giving petitioners the right to withhold the rent that would otherwise have been paid to Mr. Hilgedick, and to apply such sums directly to reduce Pacific Trencher's outstanding debt to petitioners (Pl.Exh. 22, Tab 12; 2 Appx. 255-256; see 2 Appx. 255-256).[24]

Despite these unambiguous contract provisions, the jury found that petitioners tortiously interfered with respondents' contractual and economic relations with Pacific Trencher by directing Pacific Trencher not to make the lease and equipment rental payments in question. The jury further found that petitioners tortiously interfered with Pacific Manufacturing's prospective economic advan-

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[24]The Court of Appeal appears to have mistakenly believed that the last of the above-described loan documents — the assignment of rents — had not been (1) admitted into evidence at the first trial; or (2) designated by petitioners for transmission to the Court of Appeal pursuant to California Rule of Court 10(d). See App. A, *infra*, pp. 13-14. Contrary to the court's impression, it is an indisputable fact that the assignment of rents *was* in evidence at the first trial. Pl.Exh. 22, Tab 12. It is likewise an indisputable fact that petitioners *did* timely request the trial court clerk to transmit that exhibit to the Court of Appeal. In their petition for rehearing, petitioners advised the Court of Appeal of these facts (Pet.Reh., pp. 11-12), but the court denied rehearing without correcting the erroneous statements in its opinion concerning the record on appeal. App. B, *infra*, pp. 1-2.

tage by refusing to allow Pacific Trencher to guarantee Pacific Manufacturing's performance under the government contract.

In affirming this incredible verdict, the California Court of Appeal compounded the injustice. In reliance on vague dicta in several California cases to the effect that liability for interference with business relations possibly may be found where the defendant's act is "lawful," the court held that a plaintiff may establish a prima facie case of tortious interference even where the defendant acts pursuant to a valid and lawful contract. App. A, *infra*, pp. 16-17.

This result flies in the face of the principle of fair warning mandated by the Fourteenth Amendment. Nothing in California law warned petitioners that, by exercising rights granted to them under their valid and lawful contracts with respondents and Pacific Trencher, they would be exposed to tort liability. To the contrary, at the time that petitioners exercised their contract rights, the law in California indicated that a defendant could insist that its contract with a third party be performed even though, as a result, the third party would be unable to perform its contract with the plaintiff:

> "[I]f two parties have separate contracts with a third, each may resort to any legitimate means at his disposal to secure performance of his contract even though the necessary result will be to cause a breach of the other contract." *Imperial Ice Co. v. Rossier*, 18 Cal.2d 33, 37, 112 P.2d 631 (1941) (dictum); *accord, Lawless v. Brotherhood of Painters*, 143 Cal.App.2d 474, 478, 300 P.2d 159 (1956).

To impose on petitioners liability for compensatory and punitive damages for doing that which appeared to be permitted by the plain terms of the parties' contracts amounts to a deprivation of property without fair warning, contrary to the Due Process Clause of the Fourteenth Amendment. In this regard, the case at bar may be likened to *Bouie v. City of Columbia, supra*, 378 U.S. 347. In *Bouie*, this Court held that a state court's unforeseeable and retroactive application of a state trespass statute to conduct that was clearly outside the statute's scope violated the constitutional mandate that a statute give fair warning of the conduct it

prohibits. *Id.* at 350-352. In so holding, the Court reasoned that the statutory language, which was narrow and precise, had lulled the defendants into "a false sense of security" that their conduct was not prohibited. *Id.* at 352.

Analogous considerations apply here. Petitioners' lawful and valid contracts with respondents and Pacific Trencher expressly granted petitioners certain rights. California law gave petitioners no reason to suspect that, by exercising these contract rights, they would be subjected to tort liability, let alone a staggering multi-million dollar punitive damages award. A judgment rendered in these circumstances is patently unconstitutional.

CONCLUSION

For the reasons stated, this Court should grant this petition for a writ of certiorari.

Respectfully submitted,

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Of Counsel

[Appendices Follow]

Appendix A

Not to be Published in Official Reports

In the Court of Appeal of the State of California

First Appellate District

Division Two

Steven K. Hilgedick et al.,
Plaintiffs, Respondents, and Cross-appellants,

v.

Koehring Finance Corporation et al.,
Defendants, Appellants and Cross-respondents.

Filed August 30, 1990

A039723
(Alameda County Super. Ct. No. H-79707-4)

Defendants Koehring Finance Corporation and Koehring Company (collectively "defendants") have appealed from a judgment after trial partly to the court and partly to a jury. Plaintiffs Steven Hilgedick, Hilgedick Rental Company and Bigelow-Manufacturing Company, doing business as Pacific Manufacturing, (collectively "plaintiffs") also have appealed from portions of the judgment. We have ordered these appeals consolidated in this proceeding.

STATEMENT OF THE CASE

Plaintiffs' complaint alleged five causes of action for declaratory relief, quieting title, interference with business relations, bad faith and breach of contract. The parties stipulated that the declaratory relief, quiet title and breach of contract causes of action would be submitted to the court for decision. The cause of action for interference with business relations was submitted to the jury. The court granted defendants' motion for nonsuit on the bad faith cause of action.

The jury returned a verdict in favor of plaintiffs for compensatory damages in the sum of $730,482.10. In accordance with a stipulation of the parties for a bifurcated trial on the issue of exemplary damages, the jury was then informed that the net worth of defendants was $159 million and it was instructed on the issue of exemplary damages; the jury returned a verdict of punitive damages in the identical amount of the compensatory damages. Thereafter, the court ruled in favor of defendants on the declaratory relief, quiet title and breach of contract causes of action, awarding defendants $1,986,025 in the declaratory relief cause of action together with interest on that amount at 18 percent from March 31, 1981 to the date of judgment. The court denied plaintiffs' motion for new trial on the causes of action submitted to the court. The court granted defendants' motion for new trial on the issue of exemplary damages only.

The second trial on the issue of exemplary damages began on April 21, 1987, before a different trial judge and a different jury.[1] The jury returned a verdict in favor of plaintiffs in the sum of $11 million. Judgment was then entered providing as follows: (1) plaintiffs are to recover compensatory damages of $730,482.10 with interest at 10 percent from December 27, 1982; (2) plaintiffs are to recover exemplary damages totalling $11 million with interest thereon at 10 percent from the date of the verdict of the second jury on May 14, 1987; (3) the deeds of trust and other security documents executed by plaintiffs are valid and enforceable against them in the amount of $1,986,025; (4) plaintiffs are entitled to a credit against the $1,986,025 debt owing to defendants in an amount equal to the compensatory jury verdict and defendants are entitled to interest on the difference at the rate of 18 percent; (5) no part of the exemplary damages awarded to plaintiffs is available to defendants as an offset; and (6) there is added to the judgment an amount equal to any amount recovered by defendants in the bankruptcy proceeding entitled In re Steven Hilgedick, United States Bankruptcy Court, Northern District of California, No. 4-83-02174-H, to the extent defendants' recovery

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[1] Plaintiffs appealed from the decision of the first trial judge granting a motion for new trial on the issue of exemplary damages. This appeal was later abandoned and the matter remanded to the trial court.

in that proceeding comes from funds that would not have existed but for the award of exemplary damages in this judgment.

Defendants filed before the court presiding at the second exemplary damage trial, motions to vacate the judgment, for new trial and for judgment notwithstanding the verdicts. The court denied the motion for judgment notwithstanding the verdicts but ruled the exemplary damages award in favor of Steven Hilgedick excessive by $2.5 million and granted a new trial subject to his consent to a remittitur in that amount. Hilgedick consented to the remittitur. Plaintiffs and defendants have appealed from those portions of the judgment adverse to them.

DISCUSSION

Plaintiffs and defendants have challenged determinations reached in the first liability trial and in the second trial on the issue of exemplary damages. Since the evidence presented at each trial differs somewhat, we shall discuss the issues with respect to each trial separately.

Statement of Facts

This trial commenced on December 13, 1982 and lasted eight days. Plaintiff Steven Hilgedick testified he bought 75 percent of Pacific Trencher & Equipment, Inc. in 1972. Between 1973 and 1979 Pacific Trencher's gross sales of construction equipment and of replacement parts for trenchers grew from over $1 million to over $10 million and the number of its employees increased from nine to about 70. In 1979 over 50 percent of its gross sales came from sales of used construction equipment.

Hilgedick also purchased an interest in Bigelow-Hilgedick Manufacturing Company which did business under the name Pacific Manufacturing Company. This company designed and built a new trencher called the P-40 which it sold to Pacific Trencher which in turn retailed the trenchers. Between 1973 and 1978 the annual sales volume of Pacific Manufacturing grew from $60,000 to over $1 million.

Hilgedick Rental Company, a sole proprietorship of Steven Hilgedick, bought construction machinery and made it available to Pacific Trencher for rental purposes. If Pacific Trencher had a rental customer for a machine owned by Hilgedick Rental, Pacific Trencher would rent the machine from Hilgedick Rental. Hilgedick Rental would then invoice Pacific Trencher for the rental. By 1978 Hilgedick Rental had a sales volume between $700,000 and $1 million.

Defendant Koehring Finance is a wholly owned subsidiary of Koehring Company. Koehring Finance finances sales of equipment manufactured by various divisions of Koehring Company and sold by Koehring Company or its distributors.

By 1977 Pacific Trencher was selling new lines of equipment, including machines from one of Koehring Company's divisions known as Speedstar. In late 1977 the Lorraine division of Koehring Company approached Hilgedick about selling its cranes. Hilgedick agreed to sell the cranes if he could also sell excavating equipment and backhoes produced by another division of Koehring. At the time Koehring Company had no Northern California dealer for this equipment. Agreement was reached in January 1978. In order to handle the new lines, Pacific Trencher hired additional employees and moved to a larger facility on Washington Street in San Leandro which Hilgedick purchased and leased to Pacific Trencher. The Rexnord line of construction equipment was added later with Koehring Company's agreement.

To finance this expansion, Hilgedick obtained a $1.5 million line of credit with United California Bank ("UCB") and arranged for "flooring" credit with Koehring Finance Corporation. The flooring arrangement between Pacific Trencher and Koehring Finance provided for one year without any payments for unsold equipment followed by six months of payments of interest only.

The Koehring Company cranes and tractors did not sell well. In March 1979 Pacific Trencher had to begin borrowing an average of $14,000 a month against its accounts receivable to pay interest on the unsold equipment and other operating costs.

About this time, Pacific Manufacturing began making successful bids on government contracts. Pacific Trencher acted as financial guarantor for these contracts.

In mid 1979 the bank officer who handled Pacific Trencher's line of credit at UCB left. The new bank officer did not understand the debt-to-net-worth ratio in the construction equipment industry. UCB lowered the line of credit from $1.5 million to $750,000 and dropped the advance on eligible accounts receivable from 80 to 60 percent, cutting cash flow and making it impossible for Pacific Trencher to pay its bills.

Hilgedick discussed this problem with Koehring Finance representatives at an annual convention in early 1980. In January 1980 the construction equipment industry was weakening and sales were dropping off causing concern to Koehring Finance. Rexnord and the Westinghouse Credit which floored the Rexnord line for Pacific Trencher both gave Hilgedick a three month moratorium on payments. UCB then directed Pacific Trencher's creditors to pay money owed Pacific Trencher directly to UCB, effectively cutting off Pacific Trencher's cash flow completely.

Ray Lackenbauer, president of Koehring Finance, telephoned a representative of UCB to attempt to change UCB's payment procedure. Lackenbauer was concerned about the ability of Pacific Trencher to survive as a result of UCB's new procedure.

Koehring Finance offered to loan Pacific Trencher $1 million. Lackenbauer and Clarence Miller, credit manager of Koehring Finance, visited Pacific Trencher and determined that, in their opinion, it had an excellent chance of staying in business if the loan from Koehring Finance were made.

At the time of the loan from Koehring Finance, Pacific Trencher had paid down the UCB loan to about $400,000. Hilgedick was under the impression the $1 million would be used to pay off UCB with the balance to be used for operating capital. There was no discussion of paying Koehring Finance with the proceeds of the loans. In March 1980 the value of the collateral of Pacific Trencher was approximately $5 million.

The actual loan documents, however, provided that the loan proceeds would be used to pay UCB and all amounts owing any division of Koehring. The loan documents included personal guarantees of everything Hilgedick owned, including a stock pledge of the 3000 shares of Pacific Trencher issued to Hilgedick. The subordination agreement signed by Hilgedick provided loans he made to Pacific Trencher could not be repaid until defendants had been paid in full.

At the time of the loan, Lackenbauer determined Pacific Trencher needed $1.4 million to pay its accounts payable, including Koehring Finance in the sum of $360,000. Koehring Finance wanted to loan Pacific Trencher enough to pay UCB and itself, leaving $240,000 due on other accounts payable which Koehring Finance believed could be paid from cash flow.

In April 1980 Koehring Company terminated Pacific Trencher's Lorraine distributorship and transferred it to a competitor. The reason given was Pacific Trencher was not selling enough Lorraine products. Koehring Company declined to take back the Lorraine inventory on hand at Pacific Trencher because it was no longer new equipment since it had been transferred to Hilgedick Rental. It was now impossible for Pacific Trencher to sell the cranes because it no longer had the distributorship and could not provide parts or service.

After the $1 million loan was made, the nature of Pacific Trencher's business changed drastically. Its main profit had come from sales of used equipment. Now Koehring Finance refused to finance used equipment sales or to allow Pacific Trencher to seek financing of sales of used equipment from Credit Alliance which had previously financed such sales. Pacific Trencher had to let its top used equipment salesman go.

During the summer of 1980 Koehring Finance's representatives periodically reviewed Pacific Trencher's books. Miller appeared on a monthly basis and Lackenbauer made two visits to review the books. Lackenbauer recommended a new controller to replace the one who had left. The marketing condition in the industry did not improve as Koehring Finance had predicted.

Pacific Trencher's cash flow problems resulting from lack of sales continued through the summer of 1980 into the fall. In order to raise cash, Pacific Trencher agreed to sell its Southern California operation to its employees. In order to consummate the sale, Koehring Finance had to release its security interest in the assets to be sold. Rather than filing a partial release of their security which was all that was necessary, Koehring Finance mistakenly filed a termination of security interest. Lackenbauer testified this termination "kill[ed] the file" with the Secretary of State which meant that Koehring Finance no longer had a security interest in the assets of Pacific Trencher.

In October 1980, with the rainy season only a few months away, Koehring Finance realized the impact the rainy season would have on sales would compound Pacific Trencher's cash flow problems. On October 6, 1980, Koehring Finance informed Hilgedick it was accelerating the indebtedness Pacific Trencher owed it and was assuming control of Pacific Trencher pursuant to the stock pledge signed by Hilgedick. Koehring Finance called a stockholders' meeting for October 16, 1980. Hilgedick was fired as president and new directors were appointed, the majority of whom were Koehring Finance representatives. As of April 14, 1981, Koehring Finance had not informed the shareholders of Pacific Trencher that Koehring Finance's security interest in assets of Pacific Trencher mistakenly had been terminated.

Hilgedick had prolonged conversations with Lackenbauer about his intentions in taking over Pacific Trencher. Lackenbauer denied any intention of liquidating the company. Hilgedick explained that if the company were to be liquidated it should be done at this time since the selling period for the year was over and it made no sense to allow interest costs to mount until the company was later liquidated. Lackenbauer replied Koehring Finance was not liquidating the company.

Ronald Mullins of Koehring Finance was placed in charge of collection of accounts receivable of Pacific Trencher. All monies collected from sales of Koehring equipment was sent to Koehring Finance, including at times the California sales tax collected from the consumer which then had to be paid by Pacific Trencher out of other revenue.

On December 9, 1980, Hilgedick wrote Lackenbauer stating he was revoking his personal guarantees. Lackenbauer testified that sometime in December 1980 he became aware of the fact that Koehring Finance had mistakenly filed a termination statement with the Secretary of State which was being treated as a release of Koehring Finance's security interest in all of the collateral pledged by Pacific Trencher. Koehring Finance attempted to reinstate its UCC-1 filing to reperfect its security interest. Koehring Finance also urged Hilgedick to reinstate his guarantees. Hilgedick refused to reinstate his guarantees unless his Pacific Trencher stock was returned to him.

In December 1980 Koehring Company, including Koehring Finance, was being acquired by AMCA International Corporation. AMCA was setting up a reserve to offset loses on loans on Koehring Finance's books. Lackenbauer's analysis of Pacific Trencher's assets sent to AMCA showed Pacific Trencher's collateral was sufficient to pay Koehring Finance at that time.

Lackenbauer testified that in December of 1980 he understood that if Pacific Trencher went into bankruptcy within four months of Koehring Finance's second UCC-1 filing, it could be claimed the new filing was of no effect because it would be considered a preference. He understood he should prevent Pacific Trencher's bankruptcy from occurring within the four-month period.

Although Lackenbauer was assuring Hilgedick he had no intention of liquidating Pacific Trencher, on December 22, 1980, Lackenbauer sent a letter to his superior at AMCA stating "the final decision to liquidate the distributorship will be made in January, pending audited financial statements and more importantly, the finding of an alternative distribution." Lackenbauer wrote the same superior again on January 16, 1981, that since Hilgedick was cooperating in the orderly liquidation of the company, there was no need to force Pacific Trencher into voluntary liquidation as Koehring Company had no alternate distributor available in Northern California at this time. On the other hand, in February 1981 Lackenbauer told Pacific Trencher's Board of Directors the major impediment to Koehring's extending further credit to Pacific Trencher was Hilgedick's refusal to reinstate his guarantees.

After October 16, 1980, Hilgedick Rental was not paid any rental payments by Pacific Trencher for machines it rented. No money was paid to Pacific Manufacturing for the P-40 trenchers purchased by Pacific Trencher.

Pacific Manufacturing was low bidder on two Navy contracts which required a guarantee from Pacific Trencher for Pacific Manufacturer to be awarded the contracts. Lackenbauer refused to give his permission for Pacific Trencher to sign the guarantee.

On April 3, 1981, Rexnord cancelled its dealership with Pacific Trencher and picked up its inventory. On April 1, 1981, Hilgedick received a notice of a meeting of the Board of Directors which stated Koehring Finance wished to discuss the possibility of liquidating Pacific Trencher. Hilgedick prepared financial statements to show the company could still be viable. He had not been informed Koehring Finance was planning to terminate Pacific Trencher's distributorship agreement with Koehring Company, which it did at the April 14, 1981 Board of Directors meeting. Hilgedick agreed that without the distributorship, Pacific Trencher could not continue.

On April 15, 1981, Hilgedick served Pacific Trencher with a three-day notice to pay $42,000 in rent past due for the months of November 1980 through April 1981 on the Washington Street facility or quit the premises. Koehring Finance employees caused Pacific Trencher's assets to be removed from the property. Some inventory of parts and all the books and ledgers were thrown in boxes and hauled away. Operable equipment was also removed. On April 22, 1981, the shareholders voted to put the company into bankruptcy.

Defendants' Appeal

A. Whether there was Substantial Evidence to Support the Liability Award

The jury awarded Hilgedick $42,000, Pacific Manufacturing $426,800 and Hilgedick Rental $261,682.10 for a total award of $730,482.10. On appeal, defendants claim there was no substantial evidence to support the liability verdict on the cause of action for intentional interference with economic relations. "Accord-

ingly, the scope of our review begins and ends with the determination whether, on the entire record, there is any substantial evidence, contradicted or uncontradicted, which will support the conclusions reached by the jury. In reviewing the voluminous record, we must examine all factual matters in the light most favorable to the prevailing parties and resolve all conflicts in support of the judgment." (*Kruse* v. *Bank of America* (1988) 202 Cal.App.3d 38, 51; citations omitted.)

Defendants argue plaintiffs failed to prove the elements of any one of the three separate theories upon which the tort of intentional interference with economic relations may be based: inducement to breach a contract; interference with a contractual relationship or interference with a prospective economic advantage. (*Shamblin* v. *Berge* (1985) 166 Cal.App.3d 118, 122.) Defendants assert: first, Pacific Trencher did not breach any contract; second, Koehring Finance's actions in accordance with its own contracts with plaintiffs and with Pacific Trencher did not disrupt contractual relations nor deprive plaintiffs of possible economic benefits; and third, as a matter of law, defendants' actions were privileged by virtue of express contract rights and defendants' financial interest in Pacific Trencher.

Plaintiffs assert defendants disrupted the continuing contractual relationship among Pacific Trencher and all the plaintiffs. In addition plaintiffs claim defendants interfered with prospective economic advantage of Pacific Manufacturing.

First, we must point out that defendants offer this court very little in the way of evidence presented at the liability trial to support their contention that the verdict is not supported by the evidence. Plaintiffs chide defendants for citing to evidence presented at the second trial on the issue of exemplary damages rather than evidence offered at the liability phase. Plaintiffs, however, have not followed their own advice and are guilty of the same infraction. In determining each issue raised concerning the liability trial we shall refer only to evidence presented at that trial.

Defendants cite to the following testimony of Hilgedick presented at the liability trial: he owned 92 percent of the stock of Pacific Manufacturing; during the summer of 1980 Pacific

Trencher was having problems paying Koehring Finance for equipment in inventory; and he understood that under the terms of the subordination agreement which he signed as part of the loan documents he had no right to be repaid his $450,000 loan to Pacific Trencher until Koehring Finance was paid in full. Defendants also cite to the following documentary evidence admitted at the first trial: the written guarantees of Pacific Trencher's loan signed by Hilgedick, Pacific Manufacturing and Hilgedick Rental Company; Hilgedick's agreement pledging his stock in Pacific Trencher as security for the loan; and the blanket security agreement covering all inventory, equipment and other assets of Pacific Trencher also securing the loan.

Defendants also maintain plaintiffs failed to establish interference with prospective economic advantage since plaintiffs could not reasonably anticipate future economic benefits because any business losses suffered by plaintiffs were contemplated by the parties and were a bargained-for part of the agreements securing the loan. Defendants rely on *Buckaloo* v. *Johnson* (1975) 14 Cal.3d 815, 827, for the proposition that to prevail a plaintiff must show it could reasonably anticipate future economic benefits.

Lastly, defendants argue their actions were privileged. Defendants cite *Dryden* v. *Tri-Valley Growers* (1977) 65 Cal.App.3d 990, 996, for the rule that no actionable wrong is committed where a defendant's acts consist of something which he had an absolute right to do. In support of the assertion of privilege, defendants offer *Imperial Ice Co.* v. *Rossier* (1941) 18 Cal.2d 33, 37 and *Lawless* v. *Brotherhood of Painters* (1956) 143 Cal.App.2d 474, 478, for the principle that where two parties have separate contracts with a third party, each may insist its contract be performed even if that insistence causes a breach of the other contract. Defendants also contend their actions were privileged because they had a financial interest in Pacific Trencher. *(Chicago Title Ins. Co.* v. *Great Western Financial Corp.* (1968) 69 Cal.2d 305, 319; *Lowell* v. *Mother's Cake & Cookie Co.* (1978) 79 Cal.App.3d 13, 18.)

Plaintiffs assert they presented sufficient evidence from which the jury could find defendants intentionally interfered with plaintiffs' prospective economic advantage. The elements of this tort

are: "(1) an economic relationship between the plaintiff and some third party, with the probability of future economic benefit to the plaintiff; (2) the defendant's knowledge of the relationship; (3) intentional acts on the part of the defendant designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the acts of the defendant." (*Youst* v. *Longo* (1987) 43 Cal.3d 64, 71, fn. 6.)

At the liability trial defendants *stipulated* to the following as a proper instruction to the jury: "To find liability for interference with business relations, you the jury must find from a preponderance of the evidence, that: [¶] (1) There existed business relationships or expectations with the probability of future economic benefit for the plaintiffs; [¶] (2) defendants Koehring Company and Koehring Finance Corporation, at the time they committed the acts complained of, knew of such relationships or expectations, or should have known of them; [¶] (3) but for the conduct of said defendants, plaintiffs were reasonably certain to have continued the business relationships or to have entered into relationships which offered advantages to plaintiffs; [¶] (4) the conduct of said defendants was intentional and unreasonable; and [¶] (5) that as a direct and proximate result, plaintiffs suffered damage."

We agree with plaintiff there was sufficient evidence presented to the jury from which the jury could determine defendants interfered with Hilgedick's, Hilgedick Rental's and Pacific Manufacturing's business relationships with Pacific Trencher and further interfered with Pacific Manufacturing's prospective economic advantage. We reach this conclusion with little or no help from the appellate briefs filed by plaintiffs. We agree with defendants these briefs fail to focus on the elements of the tort or the evidence related to each element. We shall discuss the evidence with respect to each plaintiff separately.

The jury awarded Hilgedick personally $42,000. This is the amount of rent due from Pacific Trencher to Hilgedick for the Washington Street premises for the months of November 1980 through April 1981 at the rate of $7,000 per month which he claimed and defendants admitted was not paid. Since the jury did not award Hilgedick any money for the promissory notes of

Pacific Trencher in the amount of $450,000 we need not discuss arguments of the parties concerning this issue.

The loan agreement between Pacific Trencher and defendants provided in paragraph 6.4 that Pacific Trencher would be allowed to pay its "reasonable expenses incurred in the ordinary course of business," including Hilgedick's salary and lease payments to Hilgedick of $7,000 per month on the Washington Street premises. In their opening brief on appeal, defendants argue that under the assignment of rents signed by Hilgedick, defendants had a right to collect the $7,000 per month rent and apply it to Pacific Trencher's indebtedness. Plaintiffs argue in their reply brief that defendants offered no evidence at the first trial to support their assertions that plaintiffs were not entitled to be paid in accordance with their contracts with Pacific Trencher and assert this court should not consider these unsupported arguments. Defendants, in their reply brief then cite to exhibit 22, tab 12, the assignment of rents, which they claim was introduced at the first trial as support for their argument.[2]

The record concerning assignment of rents at the first trial is as follows: (1) defendants' trial brief does not mention the document; (2) the clerk's exhibit record does not mention the assignment of rents; (3) exhibit 22 is described in the clerk's exhibit record as "Loan agreement between Pacific Trencher and Koehring Finance"; (4) the clerk's exhibit record does not list exhibit 22 as a group exhibit although exhibits 12 and 37 are listed as group exhibits; (5) defendants introduced into evidence each of the other documents which were purportedly part of the loan package group exhibit; the loan agreement, the promissory note, the security agreement, the assignment of stock, the stock pledge agreement and the subordination agreement as exhibits 523 through 528; (6) exhibit 22 was a plaintiffs' exhibit yet no reason has been shown why plaintiffs would introduce the assignment of rents; (7) there was no testimony concerning the assignment of rents introduced at the first trial; (8) no argument was made to

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[2] After oral argument someone had the superior court clerk send this court exhibit 22 from the second trial, a letter from defendants' trial counsel to the Secretary of State which has no bearing on the rent issue.

the jury concerning the assignment of rents at the first trial; (9) defendants made no mention of the assignment of rents in their motion for judgment notwithstanding the verdict although they made arguments about the guarantees, stock assignment, subordination agreement and deeds of trust; and (10) defendants did not seek to have the exhibits from the first trial made part of the record on appeal as provided in California Rules of Court, rule 10(d). The only suggestion in the record that exhibit 22 contained more than one document is a question by defense counsel which refers to exhibit 22 as the "loan documents." Even if we were to assume the assignment of rents were contained in exhibit 22, we do not see how a jury could have dealt with the document absent any testimony, argument or instruction concerning the document, particularly when they had before them the specific provision in the loan agreement that the rent would be paid. We conclude there was sufficient evidence before the jury that defendants caused Pacific Trencher to breach the lease terms by not paying rent to support the award of $42,000 to Hilgedick.

There was also evidence Hilgedick Rental was entitled to receive rental payments from Pacific Trencher but that defendants caused it to breach that agreement. Certainly these rental payments were reasonable expenses incurred in the ordinary course of business as contemplated by section 6.4 of the loan agreement. Hilgedick described how the business relationship operated. Hilgedick Rental purchased the equipment and made it available for Pacific Trencher to rent to customers. When Pacific Trencher rented the equipment, it paid Hilgedick Rental company a fee. Hilgedick further testified that during the summer of 1980, defendants and Hilgedick orally agreed that Hilgedick Rental would be paid only enough of the rental fees by Pacific Trencher so that it could pay the entities financing the purchase of the equipment. After defendants took over management of Pacific Trencher, Lackenbauer instructed Mullins not to make any payments to Hilgedick Rental until there was "receipt of cash resulting from the [sale] of the product." Of course, the products were for rent, not sale. Lackenbauer further testified he understood Hilgedick was not in the business of selling equipment but of renting it to Pacific Trencher which would in turn rent it to customers. He also recognized that failure to pay Hilgedick

Rental for use of the equipment would eliminate the ability of Hilgedick Rental to pay the people who financed the purchase of the equipment. Hilgedick testified the equipment was repossessed. In closing argument, defendants made no claim of a contract right or privilege to refuse payments to Hilgedick Rental but merely argued it was reasonable to withhold the payment in light of the cash shortage because Hilgedick had guaranteed the loan to Pacific Trencher. There was sufficient evidence from which the jury could find that defendants interfered with the business relationship between Hilgedick Rental and Pacific Trencher.

It was undisputed at trial that Pacific Trencher had been billed by Pacific Manufacturing about $160,000 for four P-40 trenchers purchased by Pacific Trencher from Pacific Manufacturing, that Pacific Trencher was directed by defendants not to pay for the trenchers, and that this loss of money to Pacific Manufacturing impacted its ability to receive government contracts. The total amount owed was about $200,000, including parts and service on the trenchers. Each invoice represented only the cost of the trencher to Pacific Manufacturing, that is, the direct labor cost and the overhead attributable to that trencher. The invoice was sent and was to be paid immediately upon completion of the work on a specific trencher. At the end of the year Pacific Manufacturing would bill Pacific Trencher for its profit in an amount equal to 10 percent of the total costs billed to Pacific Trencher for that year. No invoice for profit was introduced at the trial. Defendants asserted no contractual right to withhold payments to Pacific Manufacturing.

Defendants' only defense to this claim was that Pacific Trencher had received the trenchers and the invoices six to nine months before defendants took over Pacific Trencher and defendants merely carried on the policy previously established by Hilgedick of not paying Pacific Manufacturing and that Pacific Manufacturing had also guaranteed the loan to Pacific Trencher. There was no evidence Pacific Manufacturing suffered cash flow problems when Hilgedick failed to pay for the P-40 trenchers. After defendants took over Pacific Trencher, Hilgedick asked that Pacific Manufacturing be paid for the P-40 trenchers. When

defendants failed to pay for the trenchers, this caused severe cash flow problems which made its impossible for Pacific Manufacturing to receive government contracts. There was sufficient evidence from which the jury could determine defendants interfered with Pacific Manufacturing's prospective economic advantage.

Defendants also argue on appeal that under the subordination agreement, they had the right not to make payments to Hilgedick and Hilgedick Rental because that agreement also provided that Hilgedick assigned all his contract rights with Pacific Trencher to defendants. This argument was not made in the trial court. Furthermore, the only testimony concerning the subordination agreement presented at the first trial was that the agreement provided that Hilgedick would not be paid on the $450,000 promissory notes of Pacific Trencher to him. The subordination agreement itself is unclear whether it refers only to the $450,000 promissory notes or to all contract rights of Hilgedick. Absent any evidence as to the meaning of the agreement, the jury was justified in determining the subordination agreement governed payment of the promissory notes only.

Defendants' next arguments concerning justification and privilege are also without merit. Defendants' assertion that their acts were privileged as a matter of law is incorrect. Privilege and justification are questions of facts for the trier of fact. (*Lowell* v. *Mother's Cake & Cookie Co.*, *supra*, 79 Cal.App.3d at pp. 20-21.) Restatement of Torts section 767, comment d "spells out that 'the question on the issue of privilege is whether the actor's conduct was fair and reasonable under the circumstances . . . .' " (*Id.* at p. 21; italics omitted.) As further explained in *Lowell*, "The unjustifiability or wrongfulness of the act may consist of the methods used and/or the purpose or motive of the actor. . . . [I]t is underscored that the cases involving interference with prospective business advantage ' "have turned almost entirely upon the defendant's motive or purpose, and the means by which he has sought to accomplish it. As in the case of interference with contract, any manner of intentional invasion of the plaintiff's interests may be sufficient if the purpose if not a privileged one . . . ." ' " (*Id.* at p. 18; citations and italics omitted.)

Defendants' reliance on *Imperial Ice Co.* v. *Rossier, supra*, 18 Cal.2d 33, is misplaced. The justification at issue in that case was one concerning the privilege available to a competitor who interferes with another's economic relations so long as the methods used do not involve wrongful conduct. (*Id.* at pp. 38-39.) *Lawless* v. *Brotherhood of Painters, supra*, 143 Cal.App.2d 474, is also distinguishable. In *Lawless* the court recognized that one who is in a confidential relationship with a party who has contracted with a third party is privileged to induce the breach of that contract. There, an international labor union was found to have a confidential relationship with its local union. The court also found the acts of the international union were justified because the purpose of the union was to attain a legitimate labor objective. (*Id.* at p. 478.) Here, defendants were not in competition with Pacific Trencher nor did they have a confidential relationship with that entity. No public policy is involved in this case.

Defendants also claim a privilege for their actions on the grounds of financial interest in Pacific Trencher. We are inclined to believe this privilege does not apply since defendants made a loan to, not an investment in, Pacific Trencher. But even if the privilege were applicable, it would be a qualified one which turns on defendants' predominant purpose in acting as it did. (*Lowell* v. *Mother's Cake & Cookie Co., supra*, 79 Cal.App.3d at pp. 21-22.) Here, again there was ample evidence put before the jury which would support an implied finding that defendants' purpose was wrongful.

Plaintiffs offered evidence from which the jury could infer defendants real purposes behind their acts were: first, to force Hilgedick to sell their products no matter what the cost to Pacific Trencher and to plaintiffs so that Koehring Company did not have to take back its equipment in a softening market all the while knowing defendants could receive payment by the guarantors if their acts caused the demise of Pacific Trencher; second, by delaying liquidation of Pacific Trencher, thus causing interest charges to mount, in order to allow Koehring Company time to find a new distributor for Northern California and to protect defendants' second UCC-1 filing from challenge in case of Pacific Trencher's bankruptcy.

Defendants characterize plaintiffs' argument that delay in liquidating Pacific Trencher made it unable to ever pay plaintiffs as nothing more than a claim by creditors of Pacific Trencher which plaintiffs lack standing to pursue. Defendants' reliance on *Kruse* v. *Bank of America*, *supra*, 202 Cal.App.3d 38, is misplaced. Kruse failed to prove any interference by a third party; only two parties were involved. (*Id.* at p. 66.) *Smith* v. *Tele-communication, Inc.* (1982) 134 Cal.App.3d 338, 342, also relied on by defendants, is inapposite. This is not a derivative suit brought to enforce a cause of action which the corporation itself possesses but rather a suit by third parties seeking damages for interference with their economic relations with Pacific Trencher.

Defendants' other arguments on appeal deal with the second trial on the issue of exemplary damages or with certain provisions of the judgment entered after the trial. These arguments will be dealt with in a later section dealing with the second trial.

Plaintiffs' Appeal

A. Whether Damages Could be Awarded in the Declaratory Relief Action

In their appeal from the portion of the judgment dealing with the liability trial, plaintiffs first assert the trial judge erred in awarding defendants $1,986,025 on plaintiffs' declaratory relief action which was tried to the court. Plaintiffs argue defendants sought no affirmative relief in the action and plaintiffs' declaratory relief cause of action did not put damages in issue. Plaintiffs rely on the rule that where a defendant has not sought monetary damages or filed a cross-complaint it may not receive affirmative relief. (*McDougald* v. *Argonaut Land etc. Co.* (1897) 117 Cal. 87, 95; *Millgee Investment Co.* v. *Friedrich* (1967) 254 Cal.App.2d 802, 807.)

Plaintiffs' first cause of action for declaratory relief sought a determination from the court that Koehring Finance's selection to exercise Hilgedick's assignment of stock in Pacific Trencher and the voting of that stock to oust Hilgedick from control of the company together with Koehring Finance's termination of its security interest in the assets of Pacific Trencher, constituted an election on its part to accept the stock in full satisfaction of all

obligations of plaintiffs to defendants exonerating plaintiffs from any obligations as guarantors of any indebtedness of Pacific Trencher to defendants. Plaintiffs' prayer sought a declaration that plaintiffs were exonerated on their guarantees.

Defendants admitted the existence of the dispute in their answer. In their prayer, defendants sought the following relief with respect to the declaratory relief cause of action: "For an order and decree establishing that the unlimited guarantees of Hilgedick and his companies are valid and enforceable by [Koehring Finance]"; and "For an order and decree establishing that [Koehring Finance] holds a valid and enforceable lien upon the real property described in the complaint."

The judgment provided in pertinent part: "[T]he deeds of trust and other security documents executed by the plaintiffs in March, 1980 are valid and enforceable against plaintiffs to the extent of the amount owing to defendants in March 31, 1981, $1,986,025 . . . ."

Defendants claim plaintiffs' cases (*McDonald* and *Millgee, supra*) are inapposite since in those cases plaintiffs' declaratory relief causes of action did not put affirmative relief at issue and no evidence was adduced at trial to support an award of damages. Defendants rely on cases in which the pleadings embraced the issue of damages and/or the issue was actually litigated. (*California Bank* v. *Diamond* (1956) 144 Cal.App.2d 387, 390, [plaintiff's prayer sought a declaration of liability and the amount of damages was alleged in the complaint and not disputed]; *MacIsaac* v. *Pozzo* (1945) 26 Cal.2d 809, 813-814, [failure to seek proper relief is not fatal to a cause of action; defendants should have been granted leave to amend after the court granted judgment on the pleadings]; *Westerholm* v. *20th Century Ins. Co.* (1976) 58 Cal.App.3d 628, 630-631 [facts concerning issue of damages stipulated to by parties at trial].

We agree with plaintiffs that the issue of damages owed by plaintiffs to defendants was not put in issue by the pleadings and the issue was not tried in the liability trial. The record here does not support the proposition that the issue was raised by the pleadings or was litigated in the trial court. Nothing in the law

requires a party to seek monetary damages in a declaratory relief action. "The salutary purpose of the declaratory relief provisions is to permit a proper adjudication of the respective rights and obligations of the parties in order to relieve them from uncertainty and insecurity with respect to rights, status and other legal relations.... It enables a party to get a prompt adjudication without a dispute over the damages suffered. (*Lortz* v. *Connell* (1969) 273 Cal.App.2d 286, 301; citations omitted.)

Defendants also argue plaintiffs waived their right to raise this issue on appeal. Defendants first cite a sentence in plaintiffs' memorandum in support of their motion for preliminary injunction to the effect that the trial court would have to determine their liability to Koehring Finance. This statement cannot substitute for an allegation in a pleading nor does it constitute an agreement to try the issue.

Defendants cite to a single piece of evidence, their summary of amounts due from Pacific Trencher to defendants during the relevant period (Exh. 561), and point out that plaintiffs failed to object to this evidence at trial. This evidence, however, was not objectionable. It was admissible to show that at all relevant times Pacific Trencher was indebted to defendants, a fact relied on by defendants to support their theory of defense that their acts were privileged and justifiable because they were exercising their contractual rights to withhold payments to plaintiffs given them in the event of Pacific Trencher's default on loan payments. "[E]vidence which is relevant to an issue actually raised by the pleadings cannot be considered as authorizing the determination of an issue not presented." (*George Arakelian Farms, Inc.* v. *Agricultural Labor Relations Bd.* (1986) 186 Cal.App.3d 94, 104, citations and italics omitted.)

Lastly, defendants maintain plaintiffs have waived their right to raise the issue on appeal by not raising the point in the trial court. Defendants claim plaintiffs had to raise in the trial court the "defect" in defendants' pleadings, i.e., the failure of the cross-complaint to seek damages. (*Viglione* v. *City & County of S.F.* (1952) 109 Cal.App.2d 158, 160.) Defendants again cite cases where the parties litigated the issue in the trial court and then sought to raise a defect in the pleading of that issue on appeal.

(*Cockerell* v. *Title Ins. & Trust Co.* (1954) 42 Cal.2d 284, 288; *Fischer* v. *Ostby* (1954) 127 Cal.App.2d 528, 530.) That is not what happened here. Since we have determined the issue of damages not only was not pleaded but also was not litigated at the trial, the cases relied on by defendants are inapposite. Defendants' waiver argument is not meritorious.

B. The Validity of the Security Documents

Plaintiffs next assert that even if the guarantees were valid, defendants were not entitled to what plaintiffs label a "deficiency" judgment. First, plaintiffs argue defendants were not entitled to a deficiency judgment because defendants had not sold the stock in Pacific Trencher. Plaintiffs cite *Foto* v. *Bussell* (1919) 45 Cal.App. 281, 283, for the proposition that in order to obtain a deficiency judgment there must be a sale of the collateral and absent a sale there can be no deficiency and, therefore, no deficiency judgment.

Defendants accurately reply that plaintiffs' argument assumes defendants had the stock transferred to their name in satisfaction of Pacific Trencher's debt to defendants. Defendants correctly read *Foto* to hold that under Civil Code section 2819, the transfer of the stock to the name of the creditor on the company's books and the voting of that stock by the creditor does not constitute acceptance of the collateral in satisfaction of the debt. (*Id.* at p. 283.) Cases from other jurisdictions have reached the same result under the Uniform Commercial Code (UCC). (*Wisconics Engineering, Inc.* v. *Fisher* (1984) 466 N.E.2d 745, 766; *Fletcher* v. *Cobuzzi* (W.D.Pa. 1980) 499 F.Supp. 694, 698-699; *McCullough* v. *Mobiland, Inc.* (1976) 228 S.E.2d 146, 148). Except in the clearest of cases, the determination of whether a secured party has retained collateral in satisfaction of the debt is a factual question. (*Wisconics Engineering, Inc.* v. *Fisher, supra,* at p. 764.) Plaintiffs do not challenge the trial court's factual findings that there was no evidence of defendants' intent to retain the stock in lieu of the debt and that there was no evidence defendants gave the required notice of intent to do so under UCC section 9505. On the contrary, the evidence showed defendants offered the stock

back to Hilgedick even though the debt to Koehring Finance had not been paid. We conclude there is no merit to this argument.

Plaintiffs also contend there could be no deficiency judgment because defendants failed to give notice as required under the UCC of election to accept the collateral as discharge of the debt under section 9505, subdivision (2) or notice of decision to sell the collateral under section 9504, subdivision (3). The sale plaintiffs refer to in this argument is the sale of the inventory of Pacific Trencher after Koehring Finance took over management of the company. Plaintiffs treat these sales of inventory as being made by Koehring Finance rather than by Pacific Trencher. This argument fails for three reasons. First, the issue was not raised in the trial court. Whether the sales of inventory were made by Koehring Finance or by Pacific Trencher is a factual question. (*Grossman* v. *Lippson* (1978) 81 Cal.App.3d 554, 559.) The issue may not be raised for the first time on appeal. (*Parker* v. *City of Fountain Valley* (1981) 127 Cal.App.3d 99, 117.) Second, what evidence was presented on the issue shows that Hilgedick, not Koehring Finance, sold the equipment in inventory. Third, the provisions of UCC section 9504 pertain to sales by the secured creditor, not by the debtor. (*Krueger* v. *Bank of America* (1983) 145 Cal.App.3d 204, 214.) Under the UCC, guarantors are debtors. (*Connolly* v. *Bank of Sonoma County* (1986) 184 Cal.App.3d 1119, 1125.)

Lastly, plaintiffs maintain defendants did not conduct the sale of collateral in a commercially reasonable manner and this unreasonableness gives plaintiffs an absolute defense against any deficiency judgment under UCC section 9503, subdivision (3). (*Atlas Thrift Co.* v. *Horan* (1972) 27 Cal.App.3d 999, 1009.) This assertion is based upon the same sales of Pacific Trencher's inventory by Hilgedick and fails for the same three reasons given in response to plaintiffs' argument that Koehring Finance sold the inventory.

In the trial court, plaintiffs also argued the guarantees were exonerated under the suretyship defense provided by Civil Code section 2918 and UCC section 3606. These arguments are not made on appeal and we treat them as abandoned.

Because it is likely defendants will pursue a damage action based upon the security documents, we feel compelled to add that in such an action the parties may not relitigate the validity of the guarantees and deeds of trust which secured Pacific Trencher's loan, the issue of whether defendants complied with the provisions of the UCC or the issue of a suretyship defense. These issues were all litigated in the liability trial. The only issue not litigated in the present action was the amount of money owed by Pacific Trencher to defendants. We express this concern because in their reply brief, plaintiffs state that had they believed defendants had a cause of action for damages against them they would have presented evidence "including the circumstances surrounding the guarantee (and the attendant agreements regarding rent, etc.; . . .) as well as the significance of Hilgedick's revocation of the guarantee." To the extent this evidence would demonstrate the validity or invalidity of the guarantees and trust deeds or defendants' right to any judgment at all on the issues we have discussed, plaintiffs may not relitigate the issues.

The trial court did not err in finding the guarantees and deeds of trust were valid and enforceable against the guarantors.

C. The Breach of Contract Cause of Action

Plaintiffs' fifth cause of action alleges Koehring Finance breached the "guarantees by wrongfully refusing to acknowledge the termination and exoneration of said guarantees by reason of the actions of said defendants" after October 6, 1980, including the exercise of their rights under the stock pledge agreement, taking control of the Board of Directors of Pacific Trencher, directing the business activities of the company, terminating their security interest in the company's assets, crippling the company and causing it to file a petition for relief in bankruptcy. This cause of action seeks monetary damages and attorneys' fees in accordance with the attorneys' fees clause in the guarantees.

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On appeal, plaintiffs argue these actions of defendants violated the duty of good faith contained in UCC section 1203[3] in that defendants, without disclosing they no longer had a security interest in the assets of Pacific Trencher, took over the company, responded to inquiries whether they intended to liquidate the company with false statements they had no such intent, milked the company of all its assets and put the company into bankruptcy.

Defendants respond that plaintiffs ignore the limited scope of the fifth cause of action which alleges only that defendants breached the guarantees by "refusing to acknowledge the termination and exoneration of said guarantees." Defendants correctly cite to the finding of the trial court which states: "[T]he fifth cause of action alleges that defendants 'breached the contracts evidenced by guarantees by wrongfully refusing to acknowledge the termination and exoneration of said guarantees' and by 'refusing to release the deeds of trust.' [¶] As pointed out above, defendants' actions did not extinguish the liens; therefore, the claims of these two causes of action [the second seeking to quiet title and fifth] must fail, except as limited below." Since we have affirmed the decision of the trial court finding the guarantees and deeds of trust valid and enforceable, we conclude the trial court was also correct in its decision on the fifth cause of action.

D. The Tort of Bad Faith

Plaintiffs next urge that the trial court erred in granting defendants' motion for nonsuit on the fourth cause of action for bad faith breach of contract. By amendment made after trial, plaintiffs added to the fourth cause of action paragraph 59 which seeks exemplary damages on the grounds that defendants' conduct was "wilful, oppressive and in derogation of the public interest in corporate responsibility toward those who are dependent on a corporation's good faith" thus making it clear that the cause of action is for tortious breach of the duty of good faith.

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[3] Uniform Commercial Code section 1203 provides: "Every contract or duty within this code imposes an obligation of good faith in its performance."

Indeed, on appeal plaintiffs argue the trial court erred in granting nonsuit "on the tort of bad faith."

Plaintiffs argue that the bad faith tort exists where the defendant commits bad faith acts extraneous to the contract with the motive of intentionally frustrating the plaintiff's enjoyment of contract rights. (*Sawyer* v. *Bank of America* (1978) 83 Cal.App.3d 135, 139.) Plaintiffs assert this test is met here where defendants' course of conduct destroyed Pacific Trencher because defendants had lost their security interest through their own negligence and needed to find another way to protect themselves. Plaintiffs advocate a narrow reading of *Foley* v. *Interactive Data Corp.* (1988) 47 Cal.3d 654, that is, that the tort is not available in employment contracts.

Defendants note that the cause of action fails to identify the specific contract upon which the cause of action is based. In their reply brief, plaintiffs identify the guarantees as the contracts referred to in the fourth cause of action.

An allegation of breach of the covenant must be an allegation of breach of an obligation arising out of the contract itself. (*Foley* v. *Interactive Data Corp., supra,* at p. 690). The guarantees signed by each plaintiff provided that Koehring Finance had the right to proceed against that guarantor without first attempting to collect the amounts due from Pacific Trencher. Although, *Foley* was concerned with the breach of the implied duty of good faith and fair dealing in the employment context, its discussion concerning the protection afforded by the implied covenant is instructive on the issue before us. The Court stated the purpose of the implied covenant is to "protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purposes." (*Id.* at p. 690.) The implied covenant cannot be given more protection than that provided to express and implied-in-fact promises in contracts. The covenant protects "only the parties' right to receive the benefit of their agreement." It cannot be read to impose another duty on a party to the contract. Nor does the motive of the breaching party bear on the scope of damages that may be recovered for breach of a contract. (*Id.* at p. 698-699.) We reject plaintiffs' suggestion that we construe the implied covenant in the

guarantees to create a duty on the part of Koehring Finance so as to prevent the guarantors from having to pay in accordance with the terms of the agreement.

Moreover, *Foley* distinguishes insurance contracts from contracts of employment in part because the employee does not seek a "different kind of financial security than those entering a typical commercial contract. (*Id.* at p. 692.) Clearly, it is the tenor of the opinion that tort remedies should not readily be extended to commercial contracts. Here, there is no special relationship between Koehring Finance and the guarantors and the purpose of the contract was commercial profit; there is no public purpose involved.

In *Price* v. *Wells Fargo Bank* (1989) 213 Cal.App.3d 465, the first division of this court affirmed the granting of summary judgment in favor of the bank on a cause of action for tortious breach of the duty of good faith in an action brought by borrowers. The borrowers essentially argued the implied covenant created a duty of the bank of reasonable forebearance in enforcing its creditor's remedies. The court held: "Contracts are enforceable at law according to their terms. The covenant of good faith and fair dealings operates as a kind of 'safety valve' to which judges may turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of law and specific contract language. (*Foley* v. *Interactive Data Corp., supra,* 47 Cal.3d 654, 684, quoting Summers, *The General Duty of Good Faith — Its Recognition and Conceptualization* (1982) 67 Cornell L.Rev. 810, 812.) It does not impose any affirmative duty of moderation in the enforcement of legal rights." (*Price, supra,* at p. 479; internal quotation marks omitted.) In *Mitsui Manufacturers Bank* v. *Superior Court* (1989) 212 Cal.App.3d 726, plaintiffs sought tort damages for breach of the implied covenant by the bank which reneged on alleged oral agreements to renew short term credit to plaintiffs. The court held that absent a relationship roughly equivalent to the fiduciary relationship of an insured and insurer and a showing that contract damages are inadequate such an action does not exist. (*Id.* at pp. 732-733.)

Plaintiffs' reliance on *Cohen* v. *Ratinoff* (1983) 147 Cal.App.3d 321, is misplaced. That case decided that a landlord's

alleged unreasonable refusal to consent to an assignment of a commercial lease could be the basis of a tort cause of action for breach of the duty of good faith and fair dealing. That holding is based upon the public policy against unreasonable restraints on alienation. In *Kendall* v. *Ernest Pestana, Inc.* (1985) 40 Cal.3d 488, 497, footnote 11, our Supreme Court adopted the *Cohen* position to allow a cause of action for contract damages for unreasonable refusal to consent to an assignment but noted that it was not expressing any view on the merits of a claim for punitive damages based on such an allegation. The Court commented not every breach of the implied covenant of good faith in a commercial contract gives rise to an action in tort, citing *Seaman's Direct Buying Service, Inc.* v. *Standard Oil Co.* (1984) 36 Cal.3d 752, 768. We conclude the trial court was correct in granting nonsuit on the fourth cause of action.

The Second Trial

Statement of Facts

This trial commenced on April 21, 1987, before a different trial judge. On May 13, 1987, the jury returned a verdict awarding Hilgedick $5 million, Pacific Manufacturing $5 million and Hilgedick Rental $1 million in exemplary damages. After the judgment was entered, the court granted defendants' motion for new trial subject to Hilgedick's consent to a remittitur in the amount of $2.5 million; Hilgedick agreed to the remittitur. The difference between the evidence presented at the liability trial and that presented at the second exemplary damage trial is primarily one of emphasis on certain acts of defendants; however, new evidence of defendants' motives for their actions was presented.

Much more detail was offered concerning Pacific Manufacturing's government contracts. Pacific Manufacturing's first government sale was a huge trencher to be used to build 5,000 miles of tunnels for underground placement of MX missiles. Pacific Manufacturing designed the trencher and the concrete machine for this project. Hilgedick recognized that government business was not vulnerable to business cycles and Pacific Manufacturing's government contracts could tide the allied businesses over periods of general downturn. Hilgedick hired a new general manager for

Pacific Manufacturing who had experience in government bidding and contracts. Within a few months, Pacific Manufacturing was the successful bidder on a $3.9 million government contract for Hollings wenches. The government required Pacific Trencher to provide a performance guarantee of Pacific Manufacturing's contract, which was done.

When UCB cancelled Pacific Trencher's line of credit, Hilgedick did find replacement financing at least in part from two other sources but he considered the interest rate charged by one source as too high. Koehring volunteered to loan Pacific Trencher $1 million. This loan was secured by everything Hilgedick owned as well as by the guarantees of Hilgedick, Hilgedick and Pacific Manufacturing. After paying UCB and Koehring, Pacific Trencher had left from the proceeds of the loan only about $300,000 with which to meet accounts payable in the range of $700,000. Lackenbauer, the president of Koehring Finance who was an accountant with considerable experience, had calculated Pacific Trencher needed a loan of $1.4 million in order to be sound but he did not tell this to Hilgedick. One month after the loan was made, Koehring, without warning, cancelled its Lorraine distributorship with Pacific Trencher stating the reason was Pacific Trencher's financial condition.

In April 1980, Pacific Trencher received two orders for used tractors. Each order was for nearly $1 million. Hilgedick found the equipment and then sought short-term financing for about three to four weeks until Pacific Trencher would be paid. During the earlier loan negotiations, Lackenbauer had said Koehring Finance would be Pacific Trencher's banker in place of Credit Alliance. The loan documents provided Pacific Trencher could no longer use Credit Alliance as a source for borrowing funds. Lackenbauer had said Koehring Finance could loan more money if a deal looked legitimate. Yet, when Hilgedick asked Lackenbauer to finance these sales of used equipment, Lackenbauer replied "We don't want to loan you any more money." Hilgedick had to let go his used equipment salesman who had been with him for several years. With the sales of used equipment, formerly the chief source of income, stopped almost completely, cash became scarce.

On October 6, 1980, Hilgedick was sitting in his office when representatives of Koehring Finance came in and threw a bunch of papers down on his desk. They told him they were going to fire him and take over the company. He was so shocked he could not comprehend everything that was happening. They did not tell Hilgedick they had made a mistake and terminated their UCC-1 security interest in all Pacific Trencher's assets. Instead, when Hilgedick asked Lackenbauer why Koehring Finance had taken over Pacific Trencher, Lackenbauer replied "we're just trying to help you." Koehring Finance also gave as its pretext for taking over Pacific Trencher that the books of the company were in bad shape. Koehring Finance, however, had been in control of Pacific Trencher's books for months before the takeover. Lackenbauer also said he was not intending to liquidate the business to pay its debts but wanted to get the business back on its feet. Hilgedick was told to spend his time selling inventory. When he sold a piece of Koehring equipment, the total money that came in went to Koehring Finance and Pacific Trencher had to pay the sales tax and the sale commission from other money.

The government somehow found out that Hilgedick no longer owned Pacific Trencher so it required Pacific Trencher to renew its guarantee of Pacific Manufacturing's performance of the contracts. Hilgedick proposed to Lackenbauer that if he would let Pacific Trencher sign the guarantee which did not require any collateral of Pacific Trencher and would not obligate Koehring Finance in any way, then Hilgedick would agree to pay Koehring 10 percent of the monthly progress payments received by Pacific Manufacturing estimated to be about $50,000 per month and, in addition, Hilgedick would take a smaller salary and would lower the monthly rent to Pacific Trencher on the Washington Street property and pay those amounts to Koehring Finance. Hilgedick wanted to get Koehring Finance paid off so he could get his stock back. Hilgedick explained to Lackenbauer that Pacific Manufacturing definitely needed the cash flow from the government contracts. Lackenbauer said he was not interested in getting involved; he declined to allow Pacific Trencher to sign the performance guarantee. Hilgedick could never understand why his proposal was not accepted.

In December 1980, Hilgedick gave notice to Koehring Finance that he revoked his personal guarantees. Lackenbauer tried to get him to reinstate the guarantees. In order to get his stock back, Hilgedick sought a loan from the Bank of America to pay off Koehring Finance. Ron Mullins heard about the application, called the bank and told someone, "Steve Hilgedick doesn't negotiate the loan. He doesn't own the stock in the company."

During the months of January through March 1981, Hilgedick complained repeatedly to Lackenbauer and other Koehring Finance people that the refusal to allow payments to Pacific Manufacturing for equipment purchased by Pacific Trencher, the refusal to allow rent payments to Hilgedick Rental so it could meet installment payments on the equipment and the refusal to pay Hilgedick rent on the property so he could make the mortgage payments was causing serious problems. The Koehring representatives were not a bit concerned with plaintiffs' problems caused by defendants' refusal to pay them any money.

In early April 1981, Eric Hammer, the credit manager of Rexnord, called Hilgedick and told him Koehring Finance was making plans concerning Pacific Trencher but he would not tell Hilgedick what the plans were. A few days later, Hammer told Hilgedick he was terminating Rexnord's distributorship with Pacific Trencher. Hammer said Koehring Finance people had told him to close the distributorship at that time.

Janet O'Hanis, Pacific Trencher's office manager, testified she went to the Bank of America with Hilgedick and they both told Mullins they had obtained a line of credit. Mullins told them they had no right to negotiate a loan and then he called Koehring Finance and told someone there what had happened. The next day an officer of the Bank of America called to say the bank could not make the loan.

Clarence Miller, an employee of Koehring Finance, told Janet O'Hanis that if Hilgedick did not reinstate his guarantees, he would find himself in a lawsuit he could not win and he would lose everything. Miller repeated this threat to Hilgedick while Pacific Trencher was vacating the Washington Street buildings saying, "you are never going to be able to afford this lawsuit."

After Pacific Trencher was closed down, O'Hanis found herself in trouble with the IRS. She had signed Pacific Trencher's payroll checks. The IRS filed a $36,000 tax lien against her personally because Koehring Finance had not paid Pacific Trencher's payroll taxes.

Defendants' Appeal

A. Sufficiency of Evidence to Support Exemplary Damages Award

Defendants first claim there was no substantial evidence of malicious conduct to justify an award of exemplary damages. The gist of their argument is that a plaintiff must show an intent to vex, injure or annoy or a conscious disregard of plaintiffs' rights. (*Neal* v. *Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 922.) An evil motive must be shown. (*G. D. Searle & Co.* v. *Superior Court* (1975 49 Cal.App.3d 22, 29-30.)

Here, defendants argue, they presented evidence they believed their actions were in accordance with the rights granted them in the loan agreements and their motivation in acting was to protect their financial interests in a manner permitted by these agreements. It is not enough, defendants declare, for plaintiffs to show intent to do an act plus knowledge that plaintiffs will be injured by the acts. (*Silberg* v. *California Life Ins. Co.* (1974) 11 Cal.3d 452, 462-463.) According to defendants, plaintiffs showed only that defendants acted to protect their own economic interests and disregarded plaintiffs' interests. This showing is insufficient as a matter of law since this evidence falls far short of the requisite " 'act conceived in the spirit of mischief or with criminal indifference towards the obligations owed to others.' " (*Taylor* v. *Superior Court* (1979) 24 Cal.3d 890, 894.)

Defendants claim plaintiffs argued at trial the intent to injure them had been established in the first trial and defendants' disregard of plaintiffs' rights was enough to show conscious disregard. Defendants view this argument as reading out of the law the required *animus malus* by substituting conscious disregard in place of malice.

Here, defendants say, they could not reasonably foresee their wrongful acts were in "conscious disregard" of plaintiffs' rights. Such foreseeability is a condition precedent to any conscious disregard of individual rights. (*Bartling* v. *Glendale Adventist Medical Center* (1986) 184 Cal.App.3d 961, 970.)

We begin with a brief summary of our standard of review and the law concerning exemplary damages. "To justify an award of punitive damages the defendant must be guilty of oppression, fraud or malice and must act with the intent to vex, injure or annoy, or with a conscious disregard of plaintiff's rights." (*Fenlon* v. *Brock* (1989) 216 Cal.App.3d 1174, 1178-1179.) Where defendants challenge an award of exemplary damages on the ground there is insufficient evidence to support such an award, "[o]ur review begins and ends with a determination of whether there is any substantial evidence, contradicted or uncontradicted, which supports the jury's conclusion." We view the record as a whole in the light most favorable to the judgment. (*Id.* at p. 1179.)

The wording of Civil Code section 3294 in effect at the time of trial defined malice to include "conduct which is carried on by the defendant with a conscious disregard of the rights or safety of others" and oppression to mean "subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights." "Evidence establishing conscious disregard is evidence indicating that the defendant was aware of the probable consequences of his or her acts and willfully and deliberately failed to avoid those consequences." (*Duffy* v. *Cavalier* (1989) 210 Cal.App.3d 1514, 1535; citations and internal quotations marks omitted.) More than the commission of a tort is necesssary to support an award of exemplary damages. The requisite quality of intent required to award punitive damages in the context of the case before us is the wilful and deliberate failure to take steps necessary to avoid the adverse consequences of the unwarranted interference with the rights of the planitiffs. (*Weisman* v. *Blue Shield of California* (1984) 163 Cal.App.3d 61, 67.) The showing required has previously been explained by division five of this court: "Punitive damages are proper only when the tortious conduct rises to levels of extreme indifference to the plaintiff's rights, a level which decent citizens should not have to tolerate. The jury's decision to

award punitive damages is entitled to great weight, but we must review the entire record to see if there is substantial evidence from which the jury could conclude that the acts of defendant reached the level of outrage and reprehensibility to justify the award.... [¶] ... However, something more than the mere commission of a tort is always required for punitive damages." (*Flyer's Body Shop Profit Sharing Plan* v. *Ticor Title Ins. Co.* (1986) 185 Cal.App.3d 1149, 1154; citations and internal quotation marks omitted; *Hughes* v. *Blue Cross of Northern California* (1989) 215 Cal.App.3d 832, 847.)

The intent required to be shown to prove interference with prospective economic advantage is that the acts which caused the interference were committed with the design to disrupt the formation of the prospective economic relationship. (*Fisher* v. *San Pedro Peninsula Hospital* (1989) 214 Cal.App.3d 590, 619.) Thus, the intent necessary to prove the tort and the state of mind necessary to support exemplary damages are not the same. The fact that the first jury found defendants' acts intentional and unreasonable without more would not support an award of punitive damages.

"Conscious disregard can be established by 'evidence indicating that the defendant was aware of the probable consquences of his or her acts and willfully and deliberately failed to avoid those consequences.' The defendant must act with the 'intent to vex, injure, or annoy, or with a conscious disregard of the plaintiff's rights.' The common element *necessary* to find malice and oppression is the 'evil motive' of defendant. Actual malice necessary for an award of punitive damages may be inferred from the circumstances of the case." (*Slater* v. *Textron, Inc.* (1989) 214 Cal.App.3d 967, 978; citations omitted, emphasis in original.)

We are not faced with the situation presented in *Bartling* v. *Glendale Adventist Medical Center, supra,* 184 Cal.App.3d 961, relied on by defendants. There, the court held that the hospital could not have foreseen that it could have been held liable for refusing to terminate medical treatment at the request of a competent person who was being kept alive by a mechanical ventilator since courts had not yet determined the validity of a living will. The court held there was no conscious disregard of the

patient's rights at the time the hospital made its decision. (*Id.* at p. 969.) Here, the law concerning interference with prospective economic advantage was well established at the time Koehring Finance refused to allow Pacific Trencher to honor its contractual duties to plaintiffs.

Plaintiffs offered sufficient evidence from which the jury could have determined Koehring Finance's motives for its acts were wrongful. Plaintiffs stressed to the jury: that Koehring Finance took over Pacific Trencher and milked the company of its assets in order to cover up for its negligence in releasing its security interest in the company's assets; and that Koehring Finance made sure Hilgedick did not receive any money so that he would not have the resources to challenge Koehring Finance's actions by legal actions. Ample evidence was also presented from which the jury could have inferred malice in the unreasonable refusal to allow Pacific Trencher to guarantee the government contract of Pacific Manufacturing and the refusal to pay Hilgedick Rental rent for the equipment which Pacific Trencher rented to customers. Plaintiffs argued to the jury that Lackenbauer "slipped" in his testimony when he said he did not consider putting Pacific Trencher into bankruptcy when Koehring Finance took over because "In a bankruptcy we would certainly not be paid from the proceeds of Pacific Trencher." Plaintiffs' counsel asserted the only way this would be true would be if Lackenbauer knew at the time Koehring Finance took over Pacific Trencher that Koehring Finance had lost its security interest.

There was sufficient evidence of malicious conduct to support an award of exemplary damages.

B. Instructional Error Concerning the Intent Necessary to Support Exemplary Damages

Defendants maintain the trial court committed prejudicial error in instructing the second jury that they must accept as already determined by the first jury that "[t]he conduct of Defendants was intentional and unreasonable" and then instructing that punitive damages could be awarded upon a finding of malice and that " '[m]alice' means conduct which is intended by the Defendant to cause injury to the Plaintiff." Defendants argue that the

two instructions together virtually directed a verdict for the plaintiffs on the issue of intent. They do not argue either instruction by itself is incorrect. Indeed, they could not since the instruction to the first jury on the elements of the tort of interference with prospective economic advantage (including the required element that defendants' conduct was intentional and unreasonable) was stipulated to by defendants. The punitive damage instruction given tracked the language of Civil Code section 3294 and BAJI 14.71 as they read at the time of trial.

Defendants do object to the rereading of the instruction on the elements of the tort of interference with prospective economic relations to the second jury to inform that jury of the findings of the first jury. The second jury was instructed as follows: "plaintiffs have already been awarded damages sufficient to compensate them for any and all legally compensable injuries incurred as a result of Defendants' actions which are the subject of this lawsuit. You are to consider whether or not you should award additional damages against the Defendants, called punitive damages, only for the sake of example and by way of punishment. You may in your discretion award such damages, if, but only if, you find that by a preponderance of the evidence that said Defendants were guilty of malice or oppression in the conduct on which the prior jury based its finding of liability." This instruction was followed by the definitions of malice and oppression contained in section 3294 as it then provided. We believe the jury was adequately informed it had to make additional determinations about the state of mind of defendants which were not made by the first jury. Moreover, it was not error to inform the second jury of the findings necessarily included in the determination of the first jury. (See Code Civ. Proc., § 1911.)

Defendants complain that plaintiffs' counsel used these instructions to argue to the jury that since the first jury had determined defendants intended to cause the injury to plaintiffs, plaintiffs necessarily were entitled to punitive damages. Of course, it is possible such an argument could mislead a jury but that is not how we read plaintiffs' argument to the jury. Plaintiffs' counsel informed the jury that although it had been established that defendants intentionally interfered with the business relationships

of the plaintiffs, malice or oppression must also be shown to obtain punitive damages. Counsel then argued that it was unclear to him how these defendants could intend to interfere with plaintiffs' prospective economic advantage but not intend to injure plaintiffs. He gave the jury examples of defenses that could make that distinction such as where a person said I slapped another person on the back but I did not intend to injure the person. Counsel explained the two prongs of the test for malice; intent to injure and conscious disregard of others' rights and the requirement to show oppression. Counsel again explained that intent to interfere and conscious disregard of others rights are two different standards in the law but then commented that he had a hard time distinguishing one from the other in the context of this case and would look forward to defense counsel's comments on the point.

Defense counsel, for whatever reason, never directly addressed the issue in closing argument. He argued that Lackenbauer in his heart believed he had the right to do the things he did and that he acted in good faith.

In closing argument, plaintiffs' counsel again addressed the issue commenting that malice is defined as "intent to injure or conscious disregard of rights." Plaintiffs' counsel then noted he had waited to hear defense counsel explain how defendants could have intended to interfere with plaintiffs' business relationships but not intended to injure plaintiffs; or how they could intentionally interfere with those rights and yet not consciously disregard plaintiffs' rights; but that all he had heard was the improper argument that the first jury was wrong.

We determine the jury was adequately informed that the finding of the first jury did not control the second jury on the issue of malice or oppression to support an award of punitive damages. Furthermore, we find nothing to support defendants' assertion that plaintiffs' counsel misled the jury.

If there was any ambiguity inherent in the jury instructions, it would be the defendants' burden to propose instructions to clear up such ambiguity. Defendants offered instructions they claim would have clarified the ambiguity of which they now complain.

Defendants contend the court erred in not giving four instructions proposed by defendants.[4]

Instruction 13 was properly denied by the trial court. In the trial court defendants cited *Seaman's Direct Buying Service, Inc.* v. *Standard Oil Co.*, *supra*, 36 Cal.3d 752, in support of this instruction. They argued that since interference with contractual relations requires " 'intentional acts on the part of the defendant designed to disrupt the relationship' " (*id.* at p. 766), the same definition of intent must govern the "intent to cause injury" which constitutes malice necessary to support punitive damages. This is not a correct statement of the law. Defendants offer no authority and we find none for their proposition that the intent necessary to show malice differs depending on the tort involved. The intent necessary to support a finding of malice was stated by our Supreme Court in *Schroeder* v. *Auto Driveaway Co.* (1974) 11 Cal.3d 908, 922: "Defendants contend, however, that since they

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[4] Defendants' Proposed Instruction No. 13:

"For purposes of determining whether a defendant acted with malice, to act with the intent to cause injury means to act with the specific purpose or design of injuring the plaintiff. It is not enough that a defendant intended to perform the act which caused the injury, or [the] probable result of the act was known to the defendant."

Defendants' Proposed Instruction No. 13A:

"Whether a defendant acts with intent to cause injury depends upon his motive or purpose in acting. An intent to disrupt the plaintiff's contractual relations is not an intent to cause injury if the defendant was motivated by some legitimate purpose."

Defendants' Proposed Instruction No. 14:

"A wrongful act committed by mistake, in the assertion of a supposed right, or without any wrong intention, does not warrant punitive damages."

Defendants' Proposed Instruction No. 14A:

"A civil wrong committed by mistake in the assertion of a supposed right or without any actual wrong intention, and without a conscious disregard of the rights of others, will not support the giving of punitive damages."

had no intent to vex, annoy, or injure plaintiffs, exemplary damages cannot be awarded. We assume defendants felt no personal animus toward plaintiffs. But 'intent,' in the law of torts, denotes not only those results the actor desires, but also those consequences which he knows are substantially certain to result from his conduct." (*Id.* at p. 922, citations omitted.)

Furthermore, the court instructed the jury on the definition of malice as contained in BAJI No. 14.71 (7th Ed. 1986): " 'Malice' means conduct which is intended by the Defendant to cause injury to the Plaintiff or carried on by the Defendant with a conscious disregard of the rights of others. A person acts with conscious disregard of the rights of others when he is aware that his conduct will probably result in a violation of the rights of others and willfully and deliberately fails to avoid that consequence." To the extent that defendants' proposed instruction merely repeats the definition of malice given by the court it is unnecessary; since it omits part of the definition of malice, it is incorrect. " ' "Malice" means conduct which is intended by the defendant to cause injury to the plaintiff or conduct which is carried on by the defendant with a conscious disregard of the rights or safety of others. "Oppression" means subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights. Under these statutory definitions, punitive damages thus may be predicated either on an intent to harm or a conscious disregard of another's rights.' " (*Hughes* v. *Blue Cross of Northern California, supra,* 215 Cal.App.3d 832, 846.)

Proposed Instruction 13A was also correctly denied. This instruction seeks to inform the jury that there is no wrongful intent to disrupt economic relationships where the defendant is motivated by a legitimate purpose. This is nothing more than the defense of justification or privilege which were presented to the first jury. It would have been improper to present the issues anew to the second jury for a redetermination.

Instructions 14 and 14A both seek to offer the jury a defense of mistake. To the extent that the mistake defense relies upon evidence also presented to the first jury it is again an attempt to relitigate the justification or privilege defenses offered the first jury and, therefore, improper. To the extent the instruction relied

upon a new defense presented at the second trial, this defense was withdrawn by defendants and could not be the basis of the instruction. In the second trial, Lackenbauer testified he relied on the advice of counsel that he "had the legal authority to block, to prevent Pacific Trencher from making the payment" to plaintiffs based on the subordination agreement. Plaintiffs then sought to take the deposition of defendants' counsel concerning the advice he had given them. At the deposition, defendants' counsel answered some questions about discussions with his clients and then again asserted the attorney/client privilege concerning certain advice he had given. The court ruled the privilege was waived and defendant decided not to call the attorney and not to present the defense.

Further, defendants' reliance on the holding in *Lyles* v. *Perrin* (1897) 119 Cal. 264, 266, is misplaced. That Court held it was error to refuse an instruction similar to No. 14A. In *Lyles,* plaintiff offered evidence defendant sold him a piece of land and the water rights that went with that land but defendant maliciously severed the water rights from the land and sold them to a third party after the sale but before plaintiff has recorded the deed. Defendants presented evidence the sale of the water rights was inadvertent and made without intent to injure plantiff. Defendants here offered no evidence their acts were inadvertent.

The trial court did not err in rejecting defendants' proposed instructions.

C. Whether the Award of Exemplary Damages Was Excessive as a Matter of Law

Defendants argue: their conduct was not sufficiently reprehensible to justify the punitive damages awarded since this was an isolated incident and there was no widespread risk to society of the type to justify this award; the punitive damages bear no reasonable relationship to the compensatory damages awarded; and the award is more than seven percent of defendants' combined net worth.

Our standard of review of an award of punitive damages has been described by our Supreme Court as the "historically

honored standard of reversing as excessive only those judgments which the entire record, when viewed most favorably to the judgment, indicates were rendered as the result of passion and prejudice . . . . Stating the matter somehat differently in a similar case, we indicated that an appellate court may reverse such an award only when the award as a matter of law appears excessive, or where the recovery is so grossly disproportionate as to raise a presumption that it is the result of passion or prejudice." (*Neal* v. *Farmers Ins. Exchange, supra,* 21 Cal.3d at pp. 927-928; internal quotation marks omitted.)

"The decision to award punitive damages is exclusively the function of the trier of fact. So too is the amount of any punitive damage award. The relevant considerations are the nature of the defendant's conduct, the defendant's wealth, and the plantiff's actual damages." (*Gagnon* v. *Continental Casualty Co.* (1989) 211 Cal.App.3d 1598, 1602, citations omitted.) "In the final analysis, therefore, the propriety and amount of punitive damages depends entirely upon the particular facts of a case. Thus, to meaningfully apply the 'reasonable relation' rule, the trier of fact (and the reviewing court) should not focus on some bottom-line amount of an award of compensatory damages but on the nature and degree of the actual harm suffered by the plaintiff (and perhaps others)." (*Id.* at p. 1604.)

Defendants' argument that their acts were not sufficiently reprehensible is based entirely on their version of the facts presented at the second trial. Their argument is of no value to this court whatsoever since it is contrary to the requirements of our standard of review. (*Hasson* v. *Ford Motor Co.* (1982) 32 Cal.3d 388, 402.)

The ratios of the compensatory damages awards to the punitive damages awards and the ratio of the punitive damage award to defendants' net worth are all within ranges approved by other appellate courts. The ratio of the amount of punitive damages to compensatory damages in the instant case is not excessive as a matter of law. The ratio is approximately 11:1 (eight and a half million punitives and three quarter million compensatory). The California Supreme Court has upheld awards with a ratio of 78:1 (*Neal* v. *Farmers Ins. Exchange, supra,* 21 Cal.3d 910) and a

ratio of 2000:1 (*Finney* v. *Lockhart* (1950) 35 Cal.2d 161, 165). California appellate courts have upheld awards with ratios of 40:1 (*Chodos* v. *Insurance Co. of North America* (1981) 126 Cal.App 3d 86) and 32.7:1 (*Downey Savings & Loan Assn.* v. *Ohio Casualty Ins. Co.* (1987) 189 Cal.App.3d 1072). In *Goshgarian* v. *George* (1984) 161 Cal.App.3d 1214, 1228, the court approved a punitive damage award which equalled about 10 percent of the tortfeasor's net worth. Here, the trial judge carefully reviewed the punitive damages awards, considering them separately for each plaintiff and determined the award to Hilgedick was excessive but the other awards were not. Hilgedick has accepted the remittitur of his award which cut the punitive damages awarded him in half. On this record we cannot say the awards of punitive damages were excessive as a matter of law.

D. Whether the Awards of Exemplary Damages Violated the United States and/or California Constitutions

Appellants argue that the punitive damage award against them violates the excessive fines clauses of the Eighth Amendment of the United States Constitution and Article I, section 17 of the California Constitution. They also assert the award violates their right to due process under the Fourteenth Amendment of the United States Constitution and Article I, section 7 of the California Constitution. Defendants adopt the arguments of Amicus Curiae Northern California Association of Defense Counsel in its brief filed in this appeal.

The United States Supreme Court has recently determined that punitive damages do not violate the "excessive fines" clause of the Eighth Amendment. (*Browning-Ferris* v. *Kelco Disposal* (June 26, 1989) 492 U.S.___, ___ [106 L.Ed.2d 219, 236-239.) In *Browning-Ferris* and in Justice O'Connor's concurring opinion in *Bankers Life & Casualty Co.* v. *Crenshaw* (1988) 486 U.S. 71, the Court expressly did not determine whether punitive damages violate the due process clause of the Fourteenth Amendment. "[W]e have never addressed the precise question . . . : whether due process acts as a check on undue jury discretion to award punitive damages in the absence of any express statutory limit." (*Browning-Ferris*, *supra*, 106 L.Ed.2d 219, 239.)

Appellant's argument that its "due process rights were violated because it did not have 'fair warning' that its conduct would render it liable for punitive damages under Civil Code section 3294 ignores the long line of decisions in this state beginning with *Donnelly* v. *Southern Pacific Co.* (1941) 18 Cal.2d 863, 869-870, holding that punitive damages are recoverable in a nondeliberate or unintentional tort where defendant's conduct constitutes a conscious disregard of the probability of injury to others." (*Grimshaw* v. *Ford Motor Co.* (1981) 119 Cal.App.3d 757, 811.)

The California Supreme Court has already established that BAJI 14.71 and section 3294 provide adequate guidelines for a jury's determination of whether to award punitive damages. (*McCoy* v. *Hearst Corp.* (1986) 42 Cal.3d 835, 871.) While the Court has yet to speak specifically to whether BAJI 14.71 and section 3294 also provide adequate guidelines for determining the *amount* of the award, we do not foresee any threat to the sufficiency of section 3294 as the guide to trial courts.

In *Hasson* v. *Ford Motor Co., supra*, 32 Cal.3d at p. 402), the California Supreme Court directly affirmed the long-standing constitutional validity of punitive damage awards under section 3294. "In an appendix to its opening brief, [appellant] Ford offers a number of theories for holding section 3294 unconstitutional. It is not necessary to devote extensive discussion to the question: the courts have frequently and uniformly upheld that provision's validity. (E.g., *Egan* v. *Mutual of Omaha Ins. Co* (1979) 24 Cal.3d 809, 819 [citations]; *Bertero* v. *National General Corp.* (1974) 13 Cal.3d 43, 66, fn. 13 [citations]; *Zhadan* v. *Downtown L.A. Motors* (1976) 66 Cal.App.3d 481, 489 [citation]; *Merlo* v. *Standard Life & Acc. Ins. Co.* (1976) 59 Cal.App.3d 5, 19-20 [citation]; *Wetherbee* v. *United Ins. Co. of America* (1971) 18 Cal.App.3d 266, 270 [citation]; *Fletcher* v. *Western National Life Ins. Co.* (1970) 10 Cal.App.3d 376, 404 [citations]; *Toole* v. *Richardson-Merrell Inc.* (1967) 251 Cal.App.2d 689, 716-717 [citations].)" (*Id.* at fn. 2.)

In the absence of any subsequent reconsideration of this question of constitutional law by the California Supreme Court, we are compelled by stare decisis to uphold the continuing constitutional validity of Civil Code section 3294 as a standard for an award of

punitive damages. (*Auto Equity Sales, Inc.* v. *Superior Court* (1962) 57 Cal.2d 450.)

E. Whether the Alleged "Additur" Provisions of the Judgment are Valid

Defendants next challenge the portion of the judgment which provides "that the punitive damages herein awarded would not serve their purpose were the defendants able to recover, for their own use, monies that, but for the award of punitive damages against them, would not exist; accordingly, there is added to this judgment an amount equal to any amount recovered by defendant[s] in the bankruptcy proceeding entitled *In re Steve Hilgedick,* United States Bankruptcy Court, Northern District of California, No. 4-83-02174-H, to the extent that defendants' recovery, in that proceeding, is a recovery from funds that would not have existed but for the awarding of punitive damages in the instant action."

Defendants assert: the trial judge exceeded his power by adding this provision which adds money to a judgment; this portion of the judgment contradicts the portion of the judgment which held defendants' debt against plaintiffs was valid and enforceable; and the amount added by this provision is so uncertain as to be unenforceable.

Plaintiffs contend defendants agreed to the provision in the trial court in return for the trial court's ruling under Evidence Code section 352 which excluded evidence of defendants' $4 million claim in Hilgedick's personal bankruptcy as prejudicial and that, therefore, defendants may not now challenge the provision on appeal. Plaintiffs further assert the challenged provision is not an additur but rather a provision to insure that defendants receive no portion of the punitive damages imposed against them.

The problem arose because defendants made a claim in Hilgedick's personal bankruptcy for $4 million. The claim is based on Hilgedick's personal guarantee of the million dollar loan to Pacific Trencher and the first trial judge's determination that Pacific Trencher owned $1.9 million plus interest at 18 percent to Koehring Finance. Although we have reversed that portion of the

judgment which awarded defendants $1.9 million plus interest, the issue is not moot because the judgment entered allows a determination whether defendants may be paid a future claim based on the guarantee in the bankruptcy proceeding to the extent the funds in the bankruptcy estate are the funds obtained by Hilgedick as punitive damages. The trial court was concerned that a punitive damage award would not serve the purpose of punishment if defendants paid the money to Hilgedick and then received it back in the bankruptcy proceeding since there was less than $1 million in the bankruptcy estate absent a punitive damage award. The judge termed plaintiffs' argument the "in-one-pocket and out-of-the-other-pocket" argument.

The record on this issue is not as clear as we would wish. We can understand how both sides could interpret what happened to reach opposite conclusions. It appears both sides and the trial judge understood the statements concerned differently. Several hearings on the problem were held during recesses throughout the trial. What is clear is that defendants agreed the issue would not be a jury issue but would be determined by the court; "It's not a matter for the jury to decide." Defendants also agreed that the jury be partially informed on the issue.[5] Indeed, in their reply

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[5] "[PLAINTIFFS' COUNSEL]: What concerns me is that as far as putting aside the question of set-offs, looking to the question of punitive damages and all of that, I don't understand how the jury can assess it unless they know there is this claim out there where they might be putting money from one pocket into the other.

"THE COURT: They won't because I will advise them that I'll be taking care of that after they come in with their verdict. They are not to consider the claim.

"Let me back up. I think, and I think I said this before earlier in another session, that the jury may be advised that Koehring has a claim against the Plaintiff in bankruptcy. The amount of that claim and the validity of that claim is not for the jury to be concerned about, that the Court will —

"[PLAINTIFFS' COUNSEL]: Take that into account?

"THE COURT: — take that into account. That is the Court's province to determine.

(Footnote continued on next page.)

brief, defendants concede they agreed the court would determine the issue and the jury would not be allowed to increase the verdict in light of the bankruptcy claim. They argue now that the issue was to be decided at a later time and their agreement provided no basis for the extraordinary additur provision included in the judgment.

(Footnote continued from previous page.)

"[PLAINTIFFS' COUNSEL]: And make certain their verdict is effective or whatever?

"THE COURT: Yes.

"[PLAINTIFFS' COUNSEL]: Is that the agreement that we have, that that's what's going to be said?

"[DEFENDANTS' COUNSEL]: Your Honor will so instruct the jury. So far I think we have an agreement. If the verdict comes out and it's adverse, then we will deal with that.

"THE COURT: Yes.

"Now, Mary, could you type up that little comment I just made as to what I am going to tell the jury and I will play with it and we will make it as an instruction?

"I will submit it to the two of you beforehand.

"[DEFENDANTS' COUNSEL]: That's fine. For the sake of our Appellate people who may read this transcript, we don't waive any rights in connection with Your Honor's ruling that the fact of bankruptcy comes in or that the fact of the claim comes in. We don't agree to that.

"THE COURT: I understand.

"[DEFENDANTS' COUNSEL]: Based on those rulings.

"THE COURT]: Yes. And you don't waive your rights that I should tell them that $4 million is owed?

"[PLAINTIFFS' COUNSEL]: Well, I take it the 352 motion of the Defendant is sustained?

"THE COURT: Partially sustained. I am not making either of you happy with that, so I guess that's a Solomon-like solution.

"[PLAINTIFFS' COUNSEL]: I would like to have the procedural context on the record.

"THE COURT: Yes. All rights are reserved including your right to have lunch."

On the state of this record we conclude it would be inequitable to allow defendants to now challenge the offset provision of the judgment. The trial proceeded without the jury being informed that defendants had a $4 million claim in Hilgedick's bankruptcy, evidence the trial court had ruled was admissible. Defendants agreed the court could determine the issue and the jury could be so instructed as to the bankruptcy claim but not the amount. Defendants filed a written objection to the provision as written in the proposed judgment submitted by plaintiffs and plaintiffs filed a written response to defendants' memorandum. In other words defendants received ample opportunity to argue against the provision as adopted by the court after the verdict was rendered. That is all they had been promised by the trial court.

Defendants also argue that the additur provision is contrary to the first trial judge's determination defendants did not act in bad faith in their management of Pacific Trencher and the guarantees are valid and enforceable. We have previously held the issues decided by the court in the first trial differ from the issue presented in the punitive damage trial. We find no contradiction in the two portions of the judgment.

Defendants' final argument on this issue is that the provision is too uncertain to be enforceable. A provision of a judgment is not so uncertain as to be unenforceable if the amount in question is, as here, ascertainable at a future date. (*Lufkin* v. *Lufkin* (1930) 209 Cal. 710, 714; *Pinecrest Productions, Inc.* v. *RKO Teleradio Pictures, Inc.* (1970) 14 Cal.App.3d 6, 13.)

F. Whether the Decision to deny defendants an offset is improper

Defendants challenge the provision of the judgment denying them the right to offset the $1.9 million plus interest owed by plaintiffs against the punitive damages awarded plaintiffs. The judgment provision reads: "The court finds that this portion of the judgment in favor of defendants is so related to the unconscionable conduct leading to the judgment of punitive damages against defendants that no part of the punitive damages judgment against defendants is available to defendants as an offset."

Defendants contend the judgment provision contradicts the decision of the trial judge at the first trial who stated in his intended decision, "There is nothing inequitable in requiring plaintiffs to stand by the guarantees . . . ." This statement did not purport to rule on the issue of setoff and is not pertinent to the issue raised.

Nor do we agree with defendants' argument that the court erred in finding their conduct related to the conduct leading to an award of punitive damages. They assert the $1.9 million debt arose from the loan and the purchase of machinery parts before defendants took over Pacific Trencher and the conduct upon which the punitive damages was based occurred much later and is separate and distinct. The jury could infer defendants took over Pacific Trencher in order to obtain control of its assets after defendants mistakenly released their security interest. Absent an offset, defendants, unlike the usual bankruptcy creditor, would be able to collect 100 cents on the dollar outside of the bankruptcy thus profiting from the conduct which occasioned the award of exemplary damages. The trial court had discretion to order there could be no offset. (*Margott* v. *Gem Properties, Inc.* (1973) 34 Cal.App.3d 849, 854.) "The appropriate test for abuse of discretion is whether the trial court exceeded the bounds of reason. When two or more inferences can reasonably be deduced from the facts, the reviewing court has no authority to substitute its decision for that of the trial court." (*Shamblin* v. *Brattain* (1988) 44 Cal.3d 474, 478-479.) We find no error in the offset provision of the judgment.

Plaintiffs' Appeal

A. The Motion to Vacate Judgment

Plaintiffs challenge the first trial judge's order which was entered after the second trial and which granted defendants' motion to vacate the judgment. The judge characterized the order as correcting clerical errors in the judgment. The grounds for plaintiffs' challenge are that the motion to vacate the judgment was untimely under Code of Civil Procedure section 663a and that the court was without jurisdiction to hear the motion since defendants had filed a notice of appeal from the denial of this

same motion by the trial judge presiding at the second trial on the issue of exemplary damages.

The original judgment provided in pertinent part: "It is further ordered, adjudged, and decreed that the deeds of trust and other security documents executed by the plaintiffs in March, 1980 are valid and enforceable against plaintiffs to the extent of the amount owing to defendants in March 31, 1981, $1,986,025; plaintiffs are entitled, however, to a credit against that amount in an amount equal to the jury verdict; defendants are entitled to interest on the difference at the rate of interest on the loan, Eighteen Per Cent (18%), from March 31, 1981 until the date of judgment."

The corrected judgment changed the pertinent part to read as follows: "It is further ordered, adjudged, and decreed that the deeds of trust and other security documents executed by the plaintiffs in March, 1980 are valid and enforceable against plaintiffs to the extent of the amount owing to defendants in March 31, 1981, $1,986,025; defendants are entitled to interest on the amount at the rate of interest on the loan, Eighteen Per Cent (18%), from March 31, 1981 until the date of judgment."

The issue presented is whether defendants are entitled to prejudgment interest on the entire amount of $1,986,025 from the date of the jury verdict in the first trial to the date of judgment or whether defendants are entitled to that interest only on the difference between the damages awarded defendants and those awarded plaintiffs. Since we have found that the issue of damages owed by plaintiffs to defendants on the guarantees was not litigated, we need not address this issue.

DISPOSITION

The portion of the judgment awarding defendants $1,986,025 and interest on that amount at 18 percent from March 1, 1981 is vacated. The portion of the judgment reading, "The court finds that this portion of the judgment in favor of defendants is so related to the unconscionable conduct leading to the judgment of punitive damages against defendants that no part of the punitive damages judgment against defendants is available to defendants

as an offset" is modified to read as follows: "The court finds that any future damage award in favor of defendants based upon the guarantees and deed of trust given by plaintiffs is so related to the unconscionable conduct leading to the judgment of punitive damages against defendants that no part of the punitive damages judgment against defendants may be used by defendants as an offset." As so modified, the judgment is affirmed.

Benson, J.

WE CONCUR:

Smith, Acting P.J.

Peterson, J.

Appendix B

Not to be Published in Official Reports

In the Court of Appeal of the State of California

First Appellate District

Division Two

Steven K. Hilgedick et al.,
Plaintiffs, Respondents, and Cross-appellants,

v.

Koehring Finance Corporation et al.,
Defendants, Appellants and Cross-respondents.

Filed October 1, 1990

A039723
(Alameda County Super. Ct. No. H-79707-4)

ORDER MODIFYING OPINION
AND DENYING REHEARING

THE COURT:

It is ordered that the opinion filed herein on August 30, 1990, be modified as follows:

The paragraph commencing at the bottom of page 25 and ending at the top of page 26 is deleted and the following paragraph is inserted in its place:

Defendants characterize plaintiffs' argument that delay in liquidating Pacific Trencher made it unable to ever pay plaintiffs as nothing more than a claim by creditors of Pacific Trencher which plaintiffs lack standing to pursue. Defendants' reliance on *Kruse* v. *Bank of America, supra,* 202 Cal.App.3d 38, is misplaced. In *Kruse*, Mrs. Kruse's theory of interference with economic advantage was the bank "destructively interfered with the relationship between Mrs. Kruse [the corporation's sole shareholder] and the corporation." (*Id.* at p. 65.) It was this theory the court found Mrs. Kruse did not have standing to bring because it was an

indirect attempt to assert damages to the corporation. Here, plaintiffs assert interference with rights of plaintiffs due them from Pacific Trencher with which defendants interfered. Kruse also failed to prove any interference by a third party; only two parties were involved. (*Id.* at p. 66.) *Smith* v. *Tele-communication, Inc.* (1982) 134 Cal.App.3d 338, 342, also relied on by defendants, is inapposite. This is not a derivative suit brought to enforce a cause of action which the corporation itself possesses but rather a suit by third parties seeking damages for interference with their economic relations with Pacific Trencher.

Defendant's petition for rehearing is denied.

Dated:

Smith, Acting P.J.

Appendix C

ORDER DENYING REVIEW

After Judgment by the Court of Appeal

First Appellate District

Division Two, No. A039723

S017796

In the Supreme Court of the State of California

In Bank

Steven K. Hilgedick et al.,
Respondents

v.

Koehring Finance Corporation et al.,
Appellants

Supreme Court Filed November 15, 1990

Appellants' petition for review DENIED.

/s/ LUCAS
Chief Justice

Appendix D

In The Superior Court
Of The State of California
In And For The County of Alameda

Steven K. Hilgedick, et al.,
Plaintiffs,

vs.

Koehring Finance Corporation,
Defendants.

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and Related Cross-Action.

No. H-79707-4

TENTATIVE DECISION

[FILED Feb. 7, 1983]

I. FACTS

The identity of the parties and an outline of the facts is correctly stated in defendant's trial brief, page 1, line 19 through page 15, line 8 with the following exceptions: (a) "Hilgedick" page 6, line 6 should read "Capitol Trencher; (b) the first paragraph of page 8 ("a protocol . . . limitations") should read "Koehring then managed Pacific Trencher under the following provisions among others:"

Plaintiffs' trial memorandum is also partially correct. Page 1, line 20 through page 2, line 27; and page 5, line 4 through page 6, line 26 correctly state pertinent facts.

II. PROCEDURE

The complaint is in five causes of action. The parties stipulated that the first cause of action (declaratory relief), second cause of action (quiet title) and fifth cause of action (breach of contract) were to be submitted to the court rather than to the jury for decision. The third cause of action (interference with business

relations) as amended, was submitted to the jury which returned a substantial verdict in favor of plaintiffs. The court granted defendants' motion for nonsuit as to the remaining fourth cause of action (bad faith). This memorandum, except Section V, relates to the issues between plaintiffs and defendants Koehring Company and Koehring Financial Company (jointly referred to as "Koehring"). Issues raised by other defendants and cross-complaintants will be determined in future proceedings, however, see Section V herein as to the dispute between Koehring and Mrs. Mary Hilgedick.

III. FIRST CAUSE OF ACTION

In the first cause of action plaintiffs assert that defendants' claims against them are extinguished by the following: (a) the effect of a release of a UCC Financing Statement; (b) Koehring's alleged acceptance of Hilgedick's stock in Pacific Trencher in "full satisfaction of all obligations of plaintiffs to said defendants" (¶ 22); and (c) Koehring's actions after October 6, 1980 relating to Pacific Trencher (¶ 29).

The actions on which plaintiffs rely, as alleged in the complaint, were Koehring's declaration on October 6, 1980 that Pacific Trencher was in default, accelerating the indebtedness, and demanding payment of plaintiffs under the written guarantees (¶ 17); Koehring's notice to Hilgedick that it intended to exercise its rights under the stock pledge agreement and assignment of stock (¶ 18); the shareholders' meeting of October 16, 1980 in which Koehring voted Hilgedick's stock and elected a new Board of Directors dominated by Koehring (¶ 19); the new board's removal of Hilgedick as president and installing a Koehring employee in his place (¶ 20); defendant Koehring Finance Company's (KFC) assumption of "all the rights and powers which accompanied ownership of the aforementioned stock" and its supervision of the business (¶ 21); Koehring's termination of its dealership agreement with Pacific Trencher, and removal of its parts and equipment which thereby crippled Koehring's ability to

operate and pay its debt (¶ 26)[1]; and Koehring's action in voting Pacific Trencher into bankruptcy (¶ 27).

A. Acceptance of Stock and Operation of Company as Allegedly Extinguishing Indebtedness.

A creditor may accept security in lieu of the obligation by following the specific procedure set forth in § 9505[2] which requires the giving of notice to the debtor and other specific procedures. By following the provisions of that section a creditor clearly elects to accept the security in lieu of the obligation.

A creditor who exercises his rights under a stock pledge agreement, arranges to have the stock transferred to his name, and then votes the stock does not thereby forfeit or waive his rights against the guarantor, *Foto v. Bussell* (1919) 40 Cal. App. 281.

Plaintiff asserts that Koehring's actions "subsequent to October 6, 1989 demonstrate all the indicia of ownership" of Pacific Trencher pointing to the "control exercised over fundamental aspects of the business operations" (Brief, page 11); thus, it is argued, retention of the stock and operation of the business must be equated with extinguishing the indebtedness.

There appear to be no California cases holding that a secured party is deemed to have accepted the security in lieu of the indebtedness without following the procedure of § 9505. Cases from other states indicate that the debt is not so extinguished unless the facts clearly indicate his intent to accept the collateral in lieu of the obligation. *Nelson v. Armstrong v. Massey Ferguson Credit Corp.* 582 P2d 1100, 24 UCC Rep 1378, Idaho, 1978. Accord: *Harris v. Bower,* 266 Md 579, 295 A2d 870, 11 UCC Rep 428, 55 ALR3d, 640 (1972), a leading case. The cases are

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[1] This allegation is not addressed herein because there was a total failure of proof as to any obligation by Koehring to keep this dealership alive or to refrain from removing its parts and equipment.

[2] Unless otherwise indicated, all section references are to the Commercial Code, California's version of the Uniform Commercial Code (UCC).

collected in Anno. 55 ALR3d651. No such intent was expressed here.

An exception is recognized in some jurisdiction where the retention of the collateral is "so unfair or unreasonable as to amount to a retention satisfaction of the obligation." (*Harris v. Bower supra,* 55 ALR3d at page 647.) The true explanation of these cases appears to be that the creditor's actions factually manifest an intent to retain the collateral in lieu of the debt. For example, in *Haufler v. Ardinger* 28 UCC Rep. 893 (Mass. App. Div., 1979), the creditor held the collateral, equipment and machinery, for 38 months and used it in his own business. He then sold it shortly after the debtor sued him for damages. No such extreme facts exist here.

Even retention of collateral for long periods has been held not to extinguish the debt. In *Winters Nat'l Bank and Trust Co. v. Sacer,* 660 Ohio App. 2d 31, 419, NE 2d 890, 31 UCC Rep., 794, (1979) the creditor, a bank, held shares of stock in the names of its nominee for 22 months. It was held that the bank's possession of stock for this long period of time did not manifest an intention to retain the stock in lieu of the indebtedness. A holding period of 133 days from repossession to resale of the collateral, a tractor, was held not to warrant denial of the claim for a deficiency in *Nelson v. Armstrong v. Massey Ferguson Credit Corp., supra.* Plaintiffs' argument, if adopted, would deprive a creditor of his security and make stock pledges worthless, at least as to the stock of small corporations for which there is no market. Here, Koehring operated the business, at least primarily, in an attempt to protect its secured position. On various occasions Koehring offered to return the stock to Hilgedick upon adequate assurance that the indebtedness would be paid. Since defendants never expressed any intent to retain the collateral or to operate the business (the stock) in satisfaction of the obligation, much less gave the required written notice of such a proposal, § 9505, on which plaintiff relies, is simply not applicable.

Neither is § 9504 on which plaintiff also relies, arguing that there was "a sale or disposition of the stock within the meaning" of that section (Brief, pp. 10-11). That section covers the "sale, lease, or other disposition" of collateral after default. Voting

Pacific Trencher into voluntary bankruptcy cannot be deemed such a sale or disposition. Undoubtedly, if Koehring had sold the Pacific Trencher stock to a third party there would have been a "sale" or a "disposition" within the meaning of § 9504 and that section's mandates would apply. But that is not what happened. For this reason, among others, the cases cited by plaintiffs, *Barber v. LeRoy* (1974) 40 Cal. App. 3d 334; *J.T. Jenkins Co. v. Kennedy* (1975) 45 Cal. App. 3d 474, are not in point.

B. Unreasonable Delay

Another argument asserted by plaintiffs as a grounds for extinguishing their obligations is based on the mandate of § 1203:

> "Every contract or duty within this code imposes an obligation of good faith in its performance or enforcement." (Brief pp. 12-13)

In a similar vein, plaintiffs point to the rule that implied in every contract is a covenant by each party not to do anything that will deprive the other of the benefits of the contract. They argue that the failure of a secured party to comply with this basic requirement precludes him from recovering any deficiency. Plaintiffs further claim that defendants' actions constitute bad faith (Brief pp. 12-13).

The argument is that the defendants unreasonably delayed the process of liquidation of Pacific Trencher for their own benefit thereby prejudicing plaintiffs. Does such action cause an extinguishment of the indebtedness? Plaintiffs have cited no case so holding and there appear to be no California cases to this effect. But *J.T. Jenkins Company v. Kennedy supra* characterizes *Barbara v. LeRoy supra* as holding the secured party who fails to comply with the notice requirements of a proposed sale of collateral "or who fails to conduct the sale in a commercially reasonable manner" will be barred from obtaining a deficiency judgment (45 Cal. App. 3d at p. 481). Subd. (c)(3), § 9504 requires that a sale or lease of collateral must be "in good faith and in a commercially reasonable manner." This requirement is not subject to waiver. § 9501, Subd. (3).

The cases cited by plaintiffs hold that a creditor who sells repossessed collateral without complying with statutory notice requirements will not be granted a deficiency judgment. In *Barber v. LeRoy supra,* the creditor held a note in the original amount of $18,500 secured by certain chattels, fixtures used in a cafe business. Upon alleged default the creditor seized the chattels and sold them to himself at a private sale for $350 and then sought a deficiency judgment against the debtor. Holding no such judgment was proper the court quoted *Atlas Thrift Company v. Horan,* 27 Cal. App. 3d, 999. "The rule and requirement are simple. If the secured creditor wishes a deficiency judgment he must obey the law. If he does not obey the law, he will not have his deficiency judgment." *J.T. Jenkins Company v. Kennedy supra* is similar. There a truck was sold without following the statutory notice requirments.

Does it follow by analogy from these cases that the claimed unreasonable delay extinguishes the debt? Neither reason nor authority suggests any such extension of the law. The rules on sale of collateral are clearly set forth in § 9504 and it is not onerous for a creditor to follow those simple rules. Thus it is fair to penalize the creditor who refuses to do so by depriving him of the deficiency judgment. But there are no clear-cut rules as to what is or is not an unreasonable delay. No statutory time limitations apply. If the law were to impose the penalty of loss of the creditor's rights against guarantors for any unreasonable delay in liquidating assets, however slight, creditors would be forced into hasty and imprudent disposition of assets. The weight of authority in other jurisdictions rejects plaintiffs' contentions. For example, *Jones v. Morgan*, 58 Mich., App. 455, 228 N.W. 2d 419, 16 UCC Rep. 1450, 1454-55 (1975) states:

> "Defendant interprets § 9505(2) to deprive a secured party of the right to sue on a note where he has retained collateral for an unreasonable period. While there is some authority for defendant's interpretation, White & Summers, Uniform Commercial Code, p. 980, fn 89, § 26-8, *Moran v. Holman*, 13 UCC Rep. Serv. 206 (Alas, 1973), we think the better interpretation of § 9-505(2) is that it is a provision drafted for the benefit of the secured party by allowing him the

option to retain collateral in satisfaction of the debt in certain specified situations and where he manifests that intent. A debtor who has been damaged by improper retention of collateral finds his remedy in UCC § 9-507(1) which allows him to recover from the secured party "any loss caused by a failure to comply with any of the provisions of Part 5 of the Uniform Commercial Code".[3] If the loss experienced by the debtor equals the amount due on the note, then of course, the secured party will be entitled to no recovery. The debtor is sufficiently protected by § 9-507(1) without employing a strained reading of § 9-505(2) to imply retention in satisfaction where no such result was intended by the secured party. This result is in keeping with this court's decision in *Michigan National Bank v. Marston*, 29 Mich. App. 99; 185 NW2d 47 [8 UCC Rep. 1375] (1970), which specifically rejects the contention that a creditor must sell the collateral before bringing suit on the note, the court recognizing that:

"To the extent the creditor's inaction results in injury to the debtor, the debtor has a right of recovery." 29 Mich. App. at 108 [8 UCC Rep at 1380].

Such recovery is set off against any amounts due the creditor on the note, cf. *Farmers State Bank of Parkston v. Otten*, __ SD __, 204 NW2d 178 [12 UCC Rep. 7] (1973); *Home Finance Co. v. Ratliff*, 374 SW2d494 (Ky, 1964).

Accord: *Harris v. Bower*, 266 MD 579, 295 A2d 870, 11 UCC Rep. 428, 55 ALR3d, 640 (1972).

Any possible damage sustained by plaintiffs because of any commercially unreasonable acts of defendants, including any unreasonable delay in liquidating the assets of Pacific Trencher, was included in the jury's verdict.[4] As indicated below, plaintiffs

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[3] The California Statute, § 9507, is the same.

[4] The jury was instructed, by stipulation, that in order to find defendants liable to plaintiffs for interference with business relations, the jury must find "that the conduct of said defendants was intentional and unreasonable" (Plaintiffs' Instruction No. 12). The jury was also instructed that a defendant who "does not employ wrongful means" is not

are entitled to a credit reducing the indebtedness by the amount of the verdict. The complexities of determining what is an unreasonable delay are illustrated by this case. The plaintiffs' argument is that the *only* proper course of action for defendants to follow was to liquidate the company as soon as defendants took it over in October, 1980. Plaintiffs point to Hilgedick's testimony that he asked the defendants at that time if they intended to liquidate; that he wanted them to do so if that was their intent, and that he received no answer. However, Hilgedick was sending mixed messages to defendants. His December 9, 1980 letter reciting various complaints makes no request for liquidation. His January, 1981 letter, which lists some eight specific requests to defendants, does not even hint at possible liquidation. Instead, the request relates to items aimed at keeping the business in operation. At the January 16, 1981 and February 12, 1981 meetings with Koehring officials he did not raise the subject of liquidation. As late as April, 1981 when the company was on the verge of bankruptcy, Hilgedick insisted that it had "turned the corner" and should continue in operation.

Moreover, if liquidation was the *only* prudent course on October 6 at the time of the takeover, it presumably was equally prudent the day before when Hilgedick was still running the business. As far as the evidence indicates, he had no plan, desire or intent to wind up the business at that time.

Liquidation of a business with millions of dollars in specialized assets which must be disposed of at a time of diminishing demand cannot be accomplished overnight. Defendants' desire to avoid a "fire sale" where the inventory would be sold at drastically reduced prices was reasonable and was at the time in the apparent best interest of plaintiffs as well as defendants. Indeed, much inventory was sold during this period. All but 5 or 6 of 17 pieces of equipment subject to Koehring's flooring loans and on hand on

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liable "if he acts to protect his financial interest in a reasonable manner," and that a defendant "asserting in good faith a legally protected interest of his own is not liable if he believes that his interest may otherwise be impaired or destroyed and his conduct in protecting his interest is reasonable" (Defendants' Instruction No. 3). Thus, by implication the jury found that defendants acted unreasonably.

September 30, 1980 were sold by the time Koehring voted Pacific Trencher into bankruptcy. But soaring interest rates and a weak market for construction equipment (the recession started early for those involved in the construction industry) finally compelled bankruptcy.

To some extent plaintiffs are in a poor position to complain of the delay. Apart from Hilgedick's mixed messages, one reason for the delay was sloppy bookkeeping by Pacific Trencher during the period while Hilgedick was running the company, a deficiency about which the previous lender, United California Bank (UCB) had complained. It took the accountants a number of months to create records where none existed so as to opine on the company's true financial condition.

There is nothing inequitable in requiring plaintiffs to stand by the guarantees they willingly made to induce defendants, who are not in the business of making loans like this one, to lend $1 million. (KFC's primary business was "flooring" loans—making loans on specific pieces of equipment). Defendants came to Pacific Trencher's rescue on fair terms (18% per annum fixed interest) at a time when it was probably about to collapse. At that time, March, 1980, UCB had frozen the company's accounts receivable and written to the company's creditors demanding direct payment to the bank rather than to the company. Hilgedick sought financing at various other banks but none would lend. His only available source was a finance company willing to lend at prohibitive terms—prime plus 7%, a rate which would have resulted in interest over 27% per annum during parts of the relevant period.

The delay in liquidation may well have been unwise, but it cannot be deemed an act of bad faith. Nor is there any other basis on which to conclude that the delay should justify extinguishment of the debt.

C. Release of Lien

By marking the wrong box on a UCC form in September, 1980 defendants released their security interest in all of Pacific

Trencher's assets.[5] This error cannot be attributed to plaintiffs, and plaintiffs contend that his release relieves them of any obligation as guarantors citing § 3606, Subd. (1)(b) and Civil Code § 2819 among other authorities. In the absence of waiver, plaintiffs' argument would be persuasive.

Sweeping waivers of numerous rights otherwise available to guarantors are containted in the documents which defendants required plaintiffs to sign as the time the loan was made. Some of these waivers are set forth in defendants' Trial Brief (pages 18-19) and in their Memorandum Regarding Exoneration of Guarantees (pages 5-6). Particularly relevant is the security agreement between Pacific Trencher and KFC which provides, among other things:

> "Secured Party (KFC) is hereby authorized, at any time and from time to time, without the consent of or notice to Debtor (Pacific Trencher) without incurring responsibility to Debtor, and without impairing or releasing any of Secured Party's rights, or any of the obligations of Debtor hereunder, to agree to and to cause to be done the following:
>
> (a) release any portion of the Collateral . . ."

It is well settled that guarantors may waive the rights on which plaintiffs here rely, and a waiver made in advance is valid (*Bloom v. Bender* (1957) 48 Cal. 2d 793, 800-801). Waivers similar to those involved here were upheld in *Union Bank v. Ross* (1976) 54 Cal. App. 3d 290, 294-97 which involved a bank's continuing guarantee form. That case rejected the argument that such a form is an invalid contract of adhesion.

Plaintiffs therefore waived the rights they now assert and that waiver was legally valid. Clearly, the error involved here was not

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[5] The bankruptcy court has so held. That decision is on appeal. As we enter the era of pleading by printed forms, this case is an augury of headaches to come. Here, millions of dollars of assets were held released because someone, perhaps a typist, mistakenly filled in the wrong box. According to defendants, no one extended credit to Pacific Trencher in reliance upon the release. Unless reversed on appeal, the bankruptcy court has left defendants in the status of unsecured creditors.

an act of bad faith. Assuming that the error was a commercially unreasonable act not subject to waiver, any damages to which plaintiffs are thereby entitled are included in the jury verdict.

IV. SECOND AND FIFTH CAUSES OF ACTION: QUIET TITLE, BREACH OF CONTRACT

The second and fifth causes of action are tied to the first. The second seeks to quiet title to Hilgedick's real property, free of the liens of the deeds of trust which he executed in favor of defendants. The theory is that the liens were extinguished for the reasons set forth in the first cause of action. Similarly, the fifth cause of action alleges that defendants "breached the contracts evidenced by guarantees by wrongfully refusing to acknowledge the termination and exoneration of said guarantees" and by "refusing to release the deeds of trust."

As pointed out above, defendants' actions did not extinguish the liens; therefore, the claims of these two causes of action must fail, except as limited below.

V. KOEHRING-MARY HILGEDICK DISPUTE

Since plaintiffs seek to quiet title, they have joined all of the record owners and lien holders of plaintiffs' properties as defendants, including Koehring and Mrs. Mary Hilgedick, Hilgedick's former wife. Before January 9, 1980 Mrs. Hilgedick held a $100,000 deed of trust on Hayward property owned by Hilgedick; it was executed to secure family support. On that date Hilgedick purchased San Leandro property for $1,450,000, the sellers taking back a purchse money deed of trust in the amount of $1,026,000. As part of the consideration, Hilgedick traded the Hayward property and he executed a new deed of trust in the amount of $100,000 (Exhibit 102) in favor of Mrs. Hilgedick as a substitute for the one she held on the Hayward property. In Hilgedick's opinion the San Leandro property was worth $250,000 more than he paid for it at that time so that its value was $1,700,000. The $100,000 deed of trust contained the following subordination clause:

> "This Subordinated Deed of Trust, shall, provided that no notice of default under the terms hereof than appears of record, be subject to a deed of trust or deeds of trust, to be hereafter executed by trustor, or his successor in interest, covering said property, to secure a loan or loans to Trustor from any third person not to exceed at any one time the sum of $1,400,000.00 plus the additional sum of 10% per year commencing Jan. 1, 1981 and each year thereafter, plus $250,000.00 if option is exercised for additional property.
>
> The purpose of this subordination clause is to afford Trustor the right to use said property to secure loans for the purpose of financing trustor's business borrowings, lines of credit for which said property will be required to be used as security. As *existing senior liens* on the property are retired in the future trustor may obtain replacement liens not to exceed $1,450,000.00 or $1,750,000.00 as above plus the additional sum of 10% per year commencing Jan. 1, 1981, and each year thereafter and this deed of trust will be subordinated to such liens or liens." (emphasis added)

The option was never exercised. No existing senior lien was ever retired. Both the $1,026,000 purchase money deed of trust and the $100,000 Mary Hilgedick deed of trust were recorded on January 9, 1980, the sale date. Two months later when the balance on the former lien was still approximately $1,026,000 Koehring recorded its deed of trust for the million dollar capital loan.

Citing no authority, Koehring claims priority over Mrs. Hilgedick's lien to the extent of the limit in the subordination clause, which Koehring calculates at $1,885,000. Koehring claims that the purchase money lien should be disregarded in these calculations. Mrs. Hilgedick, on the other hand, contends that it must be included so that Koehring's lien is limited to the difference between that limit ($1,400,000 or $1,450,000) and $1,026,000

Koehring's interpretation is a strained one. It fails to explain the meaning of "existing senior liens" a phrase which must refer to the $1,026,000 lien; there is no other lien to which this phrase

could apply. While the subordination clause is not a model of clarity, when one reads it as a whole, it is clear that Mrs. Hilgedick sought to limit the liens senior to hers to $1,400,000 or $1,450,000. It is illogical to suppose that she intended that amount plus the $1,026,000 lien to be senior to her lien; that would leave her entirely unprotected, since the value of the property was only $1,7000,000. Koehring emphasizes that the clause refers to deeds of trust "hereafter" executed by trustor pointing out that the $1,026,000 deed of trust was not executed after Mrs. Hilgedick's $100,000 deed of trust. Factually, the two documents were executed within a few days of each other. But there is no evidence that either Hilgedick or Mrs. Hilgedick were aware of the timing of the execution of the $1,026,000 lien; it was a "wrap" or "wraparound" deed of trust executed by the former owners, not by Hilgedick.

Agreements and liens for family support are favored by the law. On the other hand, subordination clauses are strictly construed against those seeking to enforce them. *Handy v. Gordon* 65 C 2d 578 (1967); *Miller v. Citizens Savings and Loan Assn* 248 CA2 655. The legislature has also recognized the potential unfairness of subordination clauses to note holders by enacting legislation designed to clearly warn holders of the consequences of such provisions. Civil Code § 2953.1-§ 2953.5 (These sections are not applicable to this case because the loan here was in excess of $25,000).

There remains the question as to the amount of the limit. $1,400,000 appears in the first paragraph and $1,450,000, the second paragraph of the subordination clause. Since the $1,450,000 figure comes into play only when "existing senior liens on the property are retired", an event which did not occur, the applicable limit is $1,400,000. The 10% per year escalation claim is not applicable to this case because it refers to loans made in 1981 or subsequent years; nor is the escalation clauses intended to cover unpaid accrued interest accruing on a loan, such as the Koehring loan, made in 1980.

VI. CONCLUSIONS

The deeds of trust and other security documents executed by the plaintiffs in March, 1980 are valid and enforceable against plaintiffs to the extent of the amount owing to defendants in March 31, 1981 $1,986,025 (Exhibit 561); plaintiffs are entitled, however, to a credit against that amount in an amount equal to the jury verdict; defendants are entitled to interest on the difference at the rate of interest on the loan, 18% from March 31, 1981 until the date of the Judgment.

Koehring's lien is senior to that of Mrs. Mary Hilgedick to the extent of $374,000 only ($1,400,000 less $1,026,000); the balance of Koehring's lien is junior to Mrs. Hilgedick's lien. Koehring defendants are the prevailing parties and are entitled to costs and attorneys' fees against plaintiffs. Attorneys' fees are to be detailed in defendants' memorandum of costs, showing date and nature of work performed, hours spent, and by whom work performed. Copies of bills submitted to defendants or their representatives for the services are to be attached. The fee arrangement between defendants' counsel and the clients is to be disclosed.

At such time as any motions relating to the jury verdict are disposed of and issues involving the claims of LCK Properties are determined, Koehring's counsel is to prepare a Proposed Judgment.

Dated: February 4, 1983

JOHN SUTTER
Judge of the Superior Court

Appendix E

In The Superior Court
Of The State of California
In And For The County of Alameda

Steven K. Hilgedick, et al.,
Plaintiffs,

vs.

Koehring Finance Corporation,
Defendants.

---

and Related Cross-Action.

No. H-79707-4

STATEMENT OF REASONS FOR GRANTING DEFENDANTS NEW TRIAL MOTION RE PUNITIVE DAMAGES

[FILED May 31, 1983]

The evidence in the first phase of this trial on liability and compensatory damages was weak, both as to the liability and damages, but there was some evidence upon which the jury could reasonably conclude that defendants Koehring Finance Corporation and Koehring Company ("Koehring") delayed liquidation of Pacific Trencher to serve its own ends. The Court is reluctant to disturb a jury verdict and has denied the motion for new trial as to this phase of the trial.

There is insufficient evidence, however, to support the verdict for punitive damages. After weighing the evidence, the Court is convinced from the entire record, including reasonable inferences therefrom, that the jury clearly should have reached a verdict for Koehring on this issue. Viewing the record as a whole, there is a lack of evidence of malice or oppression, and the Court is now of the opinion that it should not have submitted this issue to the jury at all.

Lack of malice or oppression is illustrated by facts set forth in the Court's Tentative Decision (pp. 10-12) as follows:

> "Any possible damage sustained by plaintiffs because of any commercially unreasonable acts of defendants, including any unreasonable delay in liquidating the assets of Pacific Trencher, was included in the jury's verdict.[4] As indicated below, plaintiffs are entitled to a credit reducing the indebtedness by the amount of the verdict. The complexities of determining what is an unreasonable delay are illustrated by this case. The plaintiffs' argument is that the *only* proper course of action for defendants to follow was to liquidate the company as soon as defendants took it over in October, 1980. Plaintiffs point to Hilgedick's testimony that he asked the defendants at that time if they intended to liquidate; that he wanted them to do so if that was their intent, and that he received no answer. However, Hilgedick was sending mixed messages to defendants. His December 9, 1980 letter reciting various complaints makes no request for liquidation. His January, 1981 letter, which lists some eight specific requests to defendants, does not even hint at possible liquidation. Instead, the request relates to items aimed at keeping the business in operation. At the January 16, 1981 and February 12, 1981 meetings with Koehring officials he did not raise the subject of liquidation. As late as April, 1981 when the company was on the verge of bankruptcy, Hilgedick insisted that it had "turned the corner" and should continue in operation.

---

[4] "The jury was instructed, by stipulation, that in order to find defendants liable to plaintiffs for interference with business relations, the jury must find "that the conduct of said defendants was intentional and unreasonable" (Plaintiffs' Instruction No. 12). The jury was also instructed that a defendant who "does not employ wrongful means" is not liable "if he acts to protect his financial interest in a reasonable manner," and that a defendant "asserting in good faith a legally protected interest of his own is not liable if he believes that his interest may otherwise be impaired or destroyed and his conduct in protecting his interest is reasonable" (Defendants' Instruction No. 3). Thus, by implication the jury found that defendants acted unreasonably."

"Moreover, if liquidation was the *only* prudent course on October 6 at the time of the takeover, it presumably was equally prudent the day before when Hilgedick was still running the business. As far as the evidence indicates, he had no plan, desire or intent to wind up the business at that time.

"Liquidation of a business with millions of dollars in specialized assets which must be disposed of at a time of diminishing demand cannot be accomplished overnight. Defendants' desire to avoid a "fire sale" where the inventory would he sold at drastically reduced prices was reasonable and was at the time in the apparent best interest of plaintiffs as well as defendants. Indeed, much inventory was sold during this period. All but 5 or 6 of 17 pieces of equipment subject to Koehring's flooring loans and on hand on September 30, 1980 were sold by the time Koehring voted Pacific Trencher into bankruptcy. But soaring interest rates and a weak market for construction equipment (the recession started early for those involved in the construction industry) finally compelled bankruptcy.

"To some extent plaintiffs are in a poor position to complain of the delay. Apart from Hilgedick's mixed messages, one reason for the delay was sloppy bookkeeping by Pacific Trencher during the period while Hilgedick was running the company, a deficiency about which the previous lender, United California Bank (UCB) had complained. It took the accountants a number of months to create records where none existed so as to opine on the company's true financial condition.

"There is nothing inequitable in requiring plaintiffs to stand by the guarantees they willingly made to induce defendants, who are not in the business of making loans like this one, to lend $1 million. (KFC's primary business was "flooring" loans—making loans on specific pieces of equipment). Defendants came to Pacific Trencher's rescue on fair terms (18% per annum fixed interest) at a time when it was probably about to collapse. At that time, March, 1980, UCB had frozen the company's accounts receivable and written to the company's creditors demanding direct payment to the

bank rather than to the compamy. Hilgedick sought financing at various other banks but none would lend. His only available source was a finance company willing to lend at prohibitive terms—prime plus 7%, a rate which would have resulted in interest over 27% per annum during parts of the relevant period.

"The delay in liquidation may well have been unwise, but it cannot be deemed an act of bad faith."

For the reasons outlined above, Koehring's delay in liquidation, although impliedly found to be unreasonable by the jury, was neither malicious nor oppressive.

The Court is particularly persuaded that there is a lack of malice or oppression on the basis of Hilgedick's repeated requests to Koehring to keep the business of Pacific Trencher in operation, including his claim in April, 1981 that the business had "turned the corner" and should continue in operation. Koehring did not act maliciously or oppressively toward plaintiffs by doing the very thing—keeping the business in operation—that they requested. The gist of plaintiffs' case is that Koehring should have closed down the business sooner despite Hilgedick's pleas to the contrary.

The motion is also granted on the ground of excessive damages because no punitive damages are justified under the facts of this case for the reasons stated above.

Dated: May 31, 1983

JOHN SUTTER
Judge of the Superior Court

Appendix F

In The Superior Court
Of The State of California
In And For The County of Alameda
Before The Honorable Mark L. Eaton, Judge
Department 32

Steven K. Hilgedick, et al.,
Plaintiffs,
vs.
Koehring Finance Corporation, et al.,
Defendants.

No. H-79707-4

ORDER

[FILED Sep. 4, 1987]

The motions of defendants to vacate the judgment and enter a different judgment and for a judgment notwithstanding the verdict having been denied and defendants' motions for a new trial having been conditionally granted on the ground that the punitive damages awarded to Steven K. Hilgedick were excessive subject to plaintiff consenting to a reduction of the verdict for punitive damages to $2.5 million and plaintiff having consented to said reduced verdict, the Court hereby sets forth its rationale for said conditional grant of a new trial as required by Section 657 of the Code of Civil Procedure.

A previous jury verdict resulted in compensatory damages awarded to Hilgedick Rental in the sum of approximately $261,000; to Pacific Manufacturing in the sum of approximately $426,000; and to Steven Hilgedick in the sum of $42,000. In this trial, the jury awarded punitive damages to Hilgedick Rentals in the sum of $1 million; to Pacific Manufacturing in the sum of $5 million; and to Steven Hilgedick in the sum of $5 million. The ratio between punitive damages and compensatory damages in the matter of Hilgedick Rentals is approximately 4X; in the matter of

Pacific Manufacturing, approximately 12X; and in the matter of Steven Hilgedick, more than 119X. The disparity between these ratios cannot be reconciled with the evidence adduced at trial, nor the law relating to the award of punitive damages. As set forth in BAJI 14.71, an instruction provided to the jury, the jury was to consider, in arriving at any award of punitive damages, the following:

1. The reprehensibility of the conduct of the defendant;

2. The amount of punitive damages which will have a deterrent effect on the defendant in the light of defendants' financial condition;

3. That the punitive damages must bear a reasonable relation to the actual damages.

Applying these factors to the evidence presented to the jury it is clear that: First, it is obvious that the amount of punitive damages which will have a deterrent effect on the defendants in the light of defendants' financial condition does not differ between the different plaintiffs. Second, as to the requirement that punitive damages must bear a reasonable relation to the actual damages, it is clear that the jury did not adopt the same relationship as to the different plaintiffs. Third, the reprehensibility of the defendants' conduct toward all three plaintiffs was essentially the same with the exception that there was some evidence to indicate a continuing course of reprehensible conduct towards Steven Hilgedick after the first jury trial.

Although it can be argued that defendants' conduct introduced into evidence relative to Steven Hilgedick between 1982 and 1987 can be the basis for increasing the award of punitive damages in favor of plaintiff Steven Hilgedick, the Court is of the opinion that those additional acts do not justify a ratio ten times higher than the punitive damages awarded to Pacific Manufacturing and 30 times higher than the ratio of punitive damages to compensatory damages awarded to Hilgedick Rentals.

The fact that Steven K. Hilgedick is a natural person and the other plaintiffs are companies may have influenced the jury. There is no basis in law for such a distinction being made

especially in light of the fact that Steven K. Hilgedick was the sole owner of Hilgedick Rentals and owned almost all of the stock of Pacific Manufacturing.

Plaintiff Steven K. Hilgedick is requested to file with this Court within ten days his written consent (having voiced his oral consent in open court) to a reduction of the verdict to $2.5 million.

DATED: September 4, 1987

SIGNED: MARK L. EATON
Judge of the Superior Court

(2)

No. 90-1369

Supreme Court, U.S.
FILED
MAR 15 1991
OFFICE OF THE CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

AMCA INTERNATIONAL FINANCE COMPANY, et al.,
Petitioners,

VS.

STEVEN K. HILGEDICK, etc., et al.,
Respondents.

SUPPLEMENTAL BRIEF PURSUANT TO SUPREME COURT RULE 15.7 IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, FIRST APPELLATE DISTRICT

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12

RULE 29.1 NOTICE

The list of parent companies and affiliates of petitioners is set forth in the petition for a writ of certiorari.

TABLE OF CONTENTS

	Page
INTRODUCTION	1
ARGUMENT	3
THIS COURT'S RECENT DECISION IN *PACIFIC MUTUAL INSURANCE CO. v. HASLIP* DEMONSTRATES THAT THE $8.5 MILLION AWARD OF PUNITIVE DAMAGES INFLICTED ON PETITIONERS VIOLATES THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT	3
CONCLUSION	7

TABLE OF AUTHORITIES

Cases

	Page
Browning-Ferris Industries v. Kelco Disposal, Inc., 492 U.S. 257, 109 S.Ct. 2909 (1989)	5
Green Oil Co. v. Hornsby, 539 So.2d 218 (Ala. 1987)	3
Missouri Pacific Ry. Co. v. Tucker, 230 U.S. 340 (1913)	5
Pacific Mutual Life Insurance Co. v. Haslip, 59 U.S.L.W. 4157 (March 4, 1991)	passim
St. Louis, I. Mt. & So. Ry. Co. v. Williams, 251 U.S. 63 (1919)	5

Constitutions

United States Constitution, Fourteenth Amendment .... passim

No. 90-1369

In the Supreme Court

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AMCA INTERNATIONAL FINANCE COMPANY, et al.,
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SUPPLEMENTAL BRIEF PURSUANT TO SUPREME COURT RULE 15.7 IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE CALIFORNIA COURT OF APPEAL, FIRST APPELLATE DISTRICT

INTRODUCTION

In *Pacific Mutual Life Insurance Co. v. Haslip*, 59 U.S.L.W. 4157 (1991), decided March 4, 1991, this Court rejected a Fourteenth Amendment challenge to an award of punitive damages imposed by an Alabama jury. The Court held that the award passed constitutional muster because the jury instructions and the rigorous post-verdict review conducted by the Alabama trial and appellate courts ensured that the award was reasonable in amount and rationally related to the twin goals of retribution and deterrence. *Id.* at 4161-4163. The Court recognized, however, that in some cases, an award of punitive damages may be so "unreasonable" as to "cross the line into the area of constitutional impropriety." *Id.* at 4163.

When compared to the punitive damages awarded in *Pacific Mutual*, the $8.5 million punitive fine assessed against petitioners

does not withstand constitutional scrutiny. This huge sanction was imposed on the basis of conduct that, on its face, was permitted by the express terms of petitioners' lawful and valid contracts with respondents and Pacific Trencher. In these circumstances, an award of this magnitude cannot be reconciled with the notion of "reasonableness" that *Pacific Mutual* indicates is a cornerstone of a constitutional punitive damages award. See *Id.* at 4161, 4162.

Moreover, the procedural protections that surrounded the award of punitive damages in *Pacific Mutual* are conspicuously absent here. Unlike *Pacific Mutual*, where the trial and appellate courts evaluated the jury's award by applying detailed substantive criteria, appellate review of the punitive damages in the present case amounted to little more than a rubber-stamping of the jury's verdict. The predictable outcome of this process is an award of punitive damages that is so divorced from notions of fundamental fairness as to "jar one's constitutional sensibilities." *Id.* at 4161. It must therefore be reversed.[1]

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[1] The decision in *Pacific Mutual* does not address the additional question for review presented by petitioners: whether the Due Process Clause prohibits the imposition of tort liability and punitive damages for conduct permitted on the face of lawful and valid contracts in the absence of prior warning that such conduct is restricted or forbidden. *See* Pet.Cert., pp. i, 25-29. We note, however, that the imposition of tort liability in such circumstances appears to be inconsistent with the overarching "concerns of reasonableness" that *Pacific Mutual* indicates are to guide any inquiry into the constitutionality of an award of damages. *See* 59 U.S.L.W. at 4161.

ARGUMENT

THIS COURT'S RECENT DECISION IN *PACIFIC MUTUAL INSURANCE CO. v. HASLIP* DEMONSTRATES THAT THE $8.5 MILLION AWARD OF PUNITIVE DAMAGES INFLICTED ON PETITIONERS VIOLATES THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

In *Pacific Mutual*, the jury assessed punitive damages in a sum that was over four times as large as the compensatory damages. This Court concluded that, while this award may have been "close to the line," it was not constitutionally invalid because: (1) the jury instructions placed sufficient constraints on the jury's discretion by ensuring that the jurors understood that the award should be no larger than necessary to serve the state's interest in punishment and deterrence; (2) the trial court conducted a thorough review of the verdict pursuant to specified criteria, stating its findings on the record; and (3), most importantly, the Alabama Supreme Court also carefully scrutinized the award in light of "detailed substantive standards" it had developed for evaluating such awards. 59 U.S.L.W. at 4161-4163.[2] This appellate review made certain that the punitive damages were "reasonable in their amount and rational in light of their purpose to punish what has occurred and to deter its repetition." *Id.* at 4162.

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[2] The Alabama Supreme Court first announced these standards in *Green Oil Co. v. Hornsby*, 539 So.2d 218, 224-225 (Ala. 1989). There, the court directed courts to consider the following factors in reviewing awards of punitive damages: (a) the relationship between the punitive damages award and the harm likely to result from the defendant's conduct as well as the harm that actually has occurred; (b) the reprehensibility of the defendant's conduct, the duration of that conduct, the defendant's awareness, any concealment, and the existence and frequency of similar past conduct; (c) the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss; (d) the defendant's "financial position"; (e) the costs of litigation; (f) the imposition of criminal sanctions on the defendant for its conduct, to be taken in mitigation; and (g) the existence of other civil awards against the defendant for the same conduct, also to be taken in mitigation.

The $8.5 million award inflicted on petitioners, by contrast, presents a textbook example of "punitive damages that 'run wild.' " *Id.* at 4161. The jury, which had been told that its power to punish was virtually limitless,[3] burdened petitioners with an enormous award of punitive damages which, even when remitted, is still larger than any punitive damages award upheld in any reported decision in California. *See* Pet.Cert., pp. 23-24 & n. 21. Moreover, this huge penalty was imposed for acts that appeared to be expressly authorized by petitioners' contractual arrangements with respondents and Pacific Trencher. *See* Pet.Cert., pp. 4-7, 18, 26-28.

Unlike *Pacific Mutual*, however, the post-verdict review in this case provided little, if any, protection against this arbitrary and excessive award. Indeed, the record reveals that the trial judge expressly approved the jury's decision to punish petitioners for doing that which their contracts appeared to authorize. In refusing to set aside or reduce as excessive the $5 million punitive damages award to Pacific Manufacturing, the trial judge stated that he was basing his decision, at least in part, on petitioners' refusal—pursuant to an express contractual provision (Pl.Exh. 22, Tab 1, p. 7, ¶ 6.8; 2 Appx. 225, 231)—to allow Pacific Trencher to guarantee performance of a government contract on which Pacific Manufacturing had submitted a bid. RT II 2098-2099, 2114-2116.[4]

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[3] The instructions expressly informed the jury that there were "no fixed standards" to follow in determining how large an award to impose. RT II 2075; *see* App. A, *infra*.

[4] Although the trial court remitted the $5 million award to Mr. Hilgedick to $2.5 million, this reduction failed to bring the award within constitutionally acceptable limits. Even as so reduced, the punitive damages awarded to Mr. Hilgedick are more than *50 times* larger than the $42,000 that the jury awarded to compensate him for the loss of rental income on the property he leased to Pacific Trencher. This award is "grossly out of proportion to the severity of the offense" and has no "understandable relationship to compensatory damages." *Pacific Mutual Insurance Co. v. Haslip, supra,* 59 U.S.L.W. at 4162.

Moreover, the California Court of Appeal's review of this incredible award was perfunctory at best. While the court paid lip service to the " 'relevant considerations' " that guide the punitive damages inquiry (Pet.Cert., App. A, p. 40), its power to disturb the award was circumscribed by the deferential "passion and prejudice" standard of review. As the court observed, in California the determination of punitive damages is " 'exclusively the function of the trier of fact,' " and an award of such damages will not be reversed unless it is so large as to indicate it was " 'rendered as the result of passion and prejudice.' " *Ibid.* Thus, the searching inquiry conducted by the Alabama courts in *Pacific Mutual* never took place in the case at bar.

The important role meaningful appellate review plays in a constitutional punitive damages system cannot be overstated. Indeed, in upholding the award in *Pacific Mutual*, the Court emphasized that the rigorous review conducted by the Alabama Supreme Court distinguished Alabama's punitive damages system from other schemes (such as that in place in California) in which awards are set aside only where they appear to result from passion and prejudice on the part of the jury. 59 U.S.L.W. at 4162, n. 10.

In any event, regardless of the procedures followed by the jury and the courts in this case, the award itself is so oppressive and disproportionate to petitioners' culpability as to render it excessive as a matter of substantive due process. In *Pacific Mutual*, this Court reaffirmed that the failure to provide meaningful limits on awards of punitive damages may invite "extreme results" that are "constitutionally unacceptable." *Id.* at 4161.[5] The $8.5 million

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[5] *See, e.g., St. Louis, I. Mt. & So. Ry. Co. v. Williams*, 251 U.S. 63, 66-67 (1919) (Due Process Clause prohibits civil penalties that are "so severe and oppressive as to be wholly disproportioned to the offense and obviously unreasonable"); *Missouri Pacific Ry. Co. v. Tucker*, 230 U.S. 340, 351 (1913) (Court invalidated jury award of liquidated damages that was "arbitrary and oppressive" and "grossly out of proportion to the possible actual damages"); *see also Browning-Ferris Industries v. Kelco Disposal, Inc.*, 492 U.S. 257, 109 S.Ct. 2909, 2923 (1989) (Brennan, J., concurring) (noting decisions indicating that "the Due Process Clause forbids damages awards that are 'grossly excessive' ").

punitive damages award imposed in this case is constitutionally unacceptable by any definition. Even after remittitur, this enormous penalty is over 11 times larger than the compensatory damages awarded to respondents. *See* Pet.Cert., pp. 6-7, 23-24. Moreover, the jury imposed this sanction on the basis of conduct that, on its face, was permitted by the express terms of petitioners' lawful and valid contracts.

When viewed against petitioners' conduct, these damages are neither "reasonable" in amount nor "rational" in light of their retributive and deterrent function; indeed, the award strains the interest in punishment and deterrence to the breaking point. Deterrence is a function of the defendant's understanding of what consequences will occur if a given course of conduct is followed. Hence, punitive damages will not rationally serve the interest in deterrence where, as here, they are imposed on the basis of conduct that, at the time it occurred, appeared to be permitted.

While numerous cases recently have raised constitutional challenges to punitive damages awards, it is difficult to imagine a more compelling scenario for reversal than that present here. The "extreme results" in this case cannot be squared with *Pacific Mutual* or with this Court's past precedents that define the boundaries of due process.

CONCLUSION

For the reasons stated above and in the petition for a writ of certiorari, petitioners respectfully request this Court to grant their petition for a writ of certiorari.

Respectfully submitted,

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[Appendix Follows]

Appendix A

JURY INSTRUCTIONS REGARDING PUNITIVE DAMAGES
(Given May 12, 1987)

* * * * *

"Plaintiffs have already been awarded damages sufficient to compensate them for any and all legally compensable injuries incurred as a result of Defendants' actions which are the subject of this lawsuit. You are to consider whether or not you should award additional damages against the Defendants, called punitive damages, only for the sake of example and by way of punishment. You may in your discretion award such damages, if, but only if, you find that by a preponderance of the evidence that said Defendants were guilty of malice or oppression in the conduct on which the prior jury based its finding of liability.

" 'Malice' means conduct which is intended by the Defendant to cause injury to the Plaintiff or carried on by the Defendant with a conscious disregard for the rights of others. A person acts with conscious disregard of the rights of others when he is aware that his conduct will probably result in a violation of the rights of others and willfully and deliberately fails to avoid that consequence.

" 'Oppression' means subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights.

"If you determine that punitive damages should be awarded, the law provides no fixed standards as to the amount of punitive damages you may award, but leaves that amount to the jury's sound discretion, exercised without passion or prejudice.

"In arriving at any award of punitive damages, you are to consider the following:

"The reprehensibility of the conduct of the Defendant;

"The amount of punitive damages which will have a deterrent effect on the Defendant in the light of Defendants' financial condition;

"That the punitive damages must bear a reasonable relationship to the actual damages." RT II 2074-2075.

* * * * *

Supreme Court, U.S.
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MAR 29 1991
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(3)

No. 90-1369

In The

Supreme Court of the United States

October Term, 1990

AMCA INTERNATIONAL FINANCE COMPANY, et al.,

Petitioners,

v.

STEVEN K. HILGEDICK, et al.,

Respondents.

Petition For A Writ Of Certiorari To The California Court Of Appeal, First Appellate District

RESPONDENTS' BRIEF IN OPPOSITION

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TABLE OF CONTENTS

Page

STATEMENT OF THE CASE 1

REASONS WHY THE WRIT SHOULD BE DENIED .. 14

I. FEDERAL QUESTIONS NOW RAISED BY PETITIONERS WERE NOT RAISED IN THE CALIFORNIA TRIAL COURT OR COURT OF APPEAL 14

A. Standards Which Petitioners Now Claim Are Vague Are The Very Standards By Which They Asked That The Jury Be Guided 14

B. Petitioners' Due Process Claim In California's Appellate Courts Was, Because Not Raised At Trial, Confined To A Contention That The Statute Is Facially Unconstitutional 16

C. Petitioners Did Not Challenge The Ratio Of Exemplary To Compensatory Damages As A Federal Question 18

II. THE JURY INSTRUCTION WAS NOT CONSTITUTIONALLY INFIRM 19

III. THE RELATIONSHIP OF EXEMPLARY TO PUNITIVE DAMAGES IS REASONABLE AND WAS THOROUGHLY CONSIDERED AND REVIEWED PURSUANT TO STANDARDS WHICH PETITIONERS REQUESTED 24

CONCLUSION 30

TABLE OF AUTHORITIES

Page

CASES

Beck v. Washington, 369 U.S. 541 (1961) 18

Bogacki v. Board of Supervisors of Riverside Co., 5 Cal.3d 771 (1971) 17

Edelman v. California, 344 U.S. 357 (1953) 16

Green Oil Co. v. Hornsby, 539 So.2d 218 (Ala. 1989) 25

Grimshaw v. Ford Motor Co., 119 Cal.App.3d 757 (1981) 15, 16, 25, 26

Jentick v. Pacific Gas and Elec. Co., 18 Cal.2d 117 (1941) 15

Kellis v. Ring, 92 Cal.App.3d 854 (1979) 16

Lynch v. Birdwell, 44 Cal.2d 839 (1955) 15

Neal v. Farmers Ins., 21 Cal.3d 910 (1978) 28

Pacific Mutual Insurance Co. v. Haslip, 59 LW 4157 (1991) ..... *passim*

Panopulos v. Maderis, 47 Cal.2d 337 (1956) 17

Parker v. City of Fountain Valley, 127 Cal App.3d 99 (1981) 17

Pusateri v. E.F. Hutton Co., Inc., 180 Cal.App.3d 247 (1986) 28

United States v. Mazurie, 419 U.S. 544 (1975) 17

United States v. National Dairy Products Corp., 372 U.S. 29 (1963) 17

United States v. Powell, 423 U.S. 87 (1975) 17

Ward v. Taggart, 51 Cal.2d 736 (1959) 17

TABLE OF AUTHORITIES – Continued

Page

STATUTES AND CODES

California Civil Code § 3294 ..... 16, 17, 18, 19

California Commercial Code § 9405 7

No. 90-1369

In The

Supreme Court of the United States

October Term, 1990

AMCA INTERNATIONAL FINANCE COMPANY, et al.,

Petitioners,

v.

STEVEN K. HILGEDICK, et al.,

Respondents.

Petition For A Writ Of Certiorari To The California Court Of Appeal, First Appellate District

RESPONDENTS' BRIEF IN OPPOSITION

Respondents Steven K. Hilgedick, Pacific Manufacturing and Hilgedick Rentals, respectfully request that this Court deny the Petition for Writ of Certiorari, seeking review of the California Court of Appeal opinion in this case. The opinion is unreported but appears as Appendix A to the Petition.

STATEMENT OF THE CASE

For six years after college, respondent Steve Hilgedick sold heavy construction equipment in Oregon, invested his commissions and, in 1972, with $60,000 in savings, bought 70% of the Pacific Trencher Company in

Hayward, California. Pacific Trencher dealt in replacement parts for trenchers (large excavators) and, in the year before Hilgedick bought it, had gross sales of $300,000 and 6 employees. By 1979, Pacific Trencher's gross sales were $10,700,000, it had about 70 employees, and its primary business was used construction equipment sales. RT 25-34, 105-106 82; II RT 692-693.[1]

After acquiring Pacific Trencher, Hilgedick started two allied businesses, respondents Pacific Manufacturing and Hilgedick Rental. Pacific Manufacturing, among other things, manufactured trenchers, designed by Hilgedick, which were sold to Pacific Trencher for retail. By 1978, Pacific Manufacturing's gross sales were $1,000,000. The next year Pacific Manufacturing entered into a new field, sales to the government. This was during the period when the federal government was planning to build 5,000 miles of tunnels for underground placement of the MX missile. Pacific Manufacturing designed a trencher and a concrete machine that was to line the MX trenches. Pacific Manufacturing's initial successful bid was for a contract of $1,300,000. RT 40-42, 86-87, 103.

This experience opened new vistas to Hilgedick. Pacific Trencher was, of course, vulnerable to normal business cycles. The federal government, however, is not vulnerable to the cycle, and manufacturing products for the federal government would tide the allied businesses over during a period of downturn. II RT 757. Hilgedick hired a new general manager for Pacific Manufacturing

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[1] "RT" refers to the Reporter's Transcript of the first trial; "II RT" means Reporter's Transcript of the second trial; "CT" means Clerk's Transcript; "Petition" means Petition for Writ of Certiorari; "Supplement" means Petitioners' Supplemental Brief Pursuant to Supreme Court Rule 15.7.

who was experienced in governmental contracts. II RT 757-758, 938-940. Shortly, Pacific Manufacturing was the successful bidder on a $3.9 million Navy contract. II RT 940-941, 785. Pacific Manufacturing also began subcontracting for companies including Westinghouse Electric and Lockheed. II RT 941-942. In order for Pacific Manufacturing successfully to bid on government contracts, it was essential that Pacific Trencher provide a performance guarantee, which it did. II RT 783, 944.

The other allied business, Hilgedick Rental, bought equipment and made it available to Pacific Trencher for rental purposes. RT 30, 44-45. By 1978, Hilgedick Rental had an annual volume of sales in the neighborhood of $1 million. RT 85.

In 1977, Hilgedick had been approached by petitioners, the Koehring group, who wanted him to carry cranes. Hilgedick, who was in the dirt business, not the lifting business, agreed to carry the cranes on condition he also carry Koehring's large excavator and backhoe lines. The dealership agreements were executed in January of 1978. RT 54-56, 67. It was understood by all parties that Pacific Trencher would have to grow, over a number of years, in order properly to handle the Koehring line, and, after the dealership agreements were executed, Hilgedick found larger quarters for his business and multiplied the number of employees. Hilgedick financed this growth with personal loans, bank credit lines, and the form of credit from Koehring known as "flooring", where the title to the machinery passes from the manufacturer to the distributor at the time when the machinery arrives but payment is not immediately due to the manufacturer. RT 64, 77, 82-85, 111-112; II RT 739, 746.

1979 and its gross of almost $11 million was an excellent year for Pacific Trencher. There was, nevertheless, bad news. The bank officer at United California

Bank who had been handling Pacific Trencher's account left and was replaced by a new executive who concluded that Trencher's net worth to debt ratio was out of line. RT 114-116; II RT 781-784. Although both Hilgedick and Koehring agreed that the new bank officer simply did not understand the debt-to-net worth ratio in the construction equipment industry (RT 145) and that there was no reason for UCB to call the loan (II RT 821), explanation about the large price of such items fell on deaf ears (RT 116) and UCB lowered Pacific Trencher's line of credit, cutting cash flow and making it impossible for Trencher to pay its bills. RT 116-122, 303.

By February of 1980, Hilgedick had received commitments from lending institutions to provide him with sufficient funds to pay off his debt to UCB and continue his business. RT 129-133, 138-139, II RT 801-802. Then Koehring's credit manager, Clarence Miller, and Finance President, Ray Lackenbauer, arrived in town, reviewed Pacific Trencher's books, criticized the proposed financing as too expensive and offered to talk with UCB, which, they said, seemed to have a problem understanding the way a business such as Trencher's was conducted. RT 139-145. And Koehring said that it would like to loan money to Pacific Trencher. RT 141; II RT 821. A few months earlier, when UCB called its loan, Pacific Trencher had owed UCB $1.5 million. RT 138-139. By March, UCB was owed only $386,000. II RT 824. In a matter of months, Pacific Trencher had been able to pay UCB well over $1 million, but its other creditors, including Koehring, had not been paid. Most of the major creditors had agreed to a 3-month payment moratorium. RT 123-124. Koehring, during the February meeting, asked Pacific Trencher to accept a $1 million loan and Hilgedick was given the impression that this money was to be used to pay off the

obligation to UCB with the balance to be used for operating capital. There was no discussion of paying, from the loan, the money owed to Koehring for "flooring". RT 146-147.

The loan papers were signed in March. It took two hours to sign all of the documents. Included were personal guarantees of everything owned by Hilgedick and a pledge of Hilgedick's Pacific Trencher stock as collateral for the loan. RT 149-151, 162-163; II RT 828. Pacific Trencher's assets at this time were $5.7 million. II RT 827. Despite the problems with UCB, Pacific Trencher had been profitable in December, January, February and March, the slow season for sales in the construction equipment business. RT 163.

The specifics of the loan agreement provided for the paying off of money owed to UCB and, additionally, the paying off of all money owed to all divisions of Koehring. RT 165. This meant that, of the $1 million, Hilgedick received only about $300,000; his accounts payable at that time were in the range of $700,000. II RT 830. Lackenbauer, an accountant of considerable talent (II RT 1565-1575), had calculated that Pacific Trencher, in order to be sound, actually needed a loan of about $1.4 million. II RT 1607. He did not, however, communicate his opinion to Hilgedick. II RT 1908.

The month after the loan agreement was executed, Koehring terminated, without warning, Pacific Trencher's crane distributorship and transferred it to Trencher's competitor, North American Equipment. The reason given for cancelling the distributorship was Pacific Trencher's "financial condition." RT 167; II RT 831-833.

The loan agreement gave Koehring great power to influence the direction of Pacific Trencher's business, and the character of that business was now altered dramatically. Until the Koehring loan, Pacific Trencher had been, primarily, a used equipment seller with gross sales of

over $5.5 million in used equipment the previous year. RT 106. The sale of large items of used equipment had to be individually financed. Pacific Trencher would have a buyer go out and find the equipment, purchase the equipment on credit, and then sell it to the buyer. The institution usually used to finance the brokering was Credit Alliance. According to Fred Wolford, who as in charge of Credit Alliance in the western states (II RT 1036), Hilgedick was a marvel at locating used equipment, finding a customer who wanted the equipment, and then brokering the exchange. II RT 1038-1039. The loan agreement between Pacific Trencher and Koehring gave Koehring the power to veto any financing for Trencher; Miller vetoed any brokerage financing from Credit Alliance. RT 170. Although the loan agreement between Pacific Trencher and Koehring provided that Koehring, itself, could assist in brokerage financing and though Lackenbauer, at the time of the loan, had emphasized this provision as applying to used-equipment sales (II RT 1909), Koehring refused to do so. On two occasions in the summer of 1980, no-risk brokerage opportunities of $1 million each were available to Pacific Trencher, but Koehring refused to provide the brokerage financing and would permit no one else to do so. Hilgedick had to let his top salesman go, a salesman who had been generating $2-3 million in used sales. RT 170-171; II RT 835-837, 976-978. Manifestly, Koehring was transforming Pacific Trencher from a primarily used equipment dealer to a new (Koehring) equipment dealer.

During the summer of 1980, Miller and Lackenbauer made numerous visits to review the books of Pacific Trencher and a new controller was hired at the direction of Lackenbauer. RT 322-323, 328; II RT 974. The accounting staff was doubled and stayed in telephonic contact with Koehring on a twice daily basis. II RT 974. With sales

of used equipment now reduced to a trickle, cash became dear. II RT 842. In order to raise cash during that summer of 1980, Pacific Trencher entered into negotiations to sell its Los Angeles assets. Miller wanted the assets sold and the proceeds used to pay Trencher's bills. RT 174-175. For the sale to be consummated, it was necessary for Koehring to release its security interest in the Los Angeles assets. To do that, Koehring had to file with the California Secretary of State a release of the security interest represented by its UCC-1 filings.

A "UCC-1 filing" is the filing by which a secured interest in collateral is established. A UCC-1 is "notice" security. A potential creditor has the opportunity to discover what secured interests precede him before extending credit. When there are disputes between or among secured creditors, the UCC-1 with the earlier date takes precedence unless there has been agreement by the earlier creditor to "subordinate" its interest. Koehring, when it extended the $1 million loan to Pacific Trencher, sought subordination from Trencher's creditors and received it from all but Credit Alliance. Credit Alliance was owed about $250,000, Pacific Trencher had assets of $5.7 million, so Koehring was secured by assets worth over $5.6 million. II RT 827; RT 318-320. Release of security is controlled by California Commercial Code § 9405 and may be partial or total. Koehring needed only to file a partial release of its UCC-1 security in Pacific Trencher, to wit: a release limited to the Los Angeles assets. But instead of filing a partial release of its UCC-1 security interest, Koehring, apparently through inadvertence, filed a total release of all its interest in Pacific Trencher The total release was filed with the California Secretary of State in September and, as of September, 1980, Koehring

had no security interest in any of the assets of Pacific Trencher. CT 843, RT 338-340, II RT 1822-23.

Koehring was now bare. It revealed its distress to no one. II RT 1827-1828, 1833-1836. Instead it decided to take over Pacific Trencher, milk the assets in which it was no longer secured and destroy Hilgedick before he could discover the situation.

On October 6, 1980, Koehring's representatives, without any prior warning (II RT 1649) appeared in Hilgedick's office, told him the debt was being accelerated and the Koehring was assuming control pursuant to the stock pledge. RT 178-80. At the time, Pacific Trencher was about $27,000 delinquent on interest due on the loan (II RT 906) and other money was owed pursuant to flooring. II RT 906-907. Koehring claimed it was taking over because of tardy payment but the reason rang hollow; Hilgedick had just sold his Los Angeles assets to satisfy Koehring and Koehring, which was functionally in charge of Pacific Trencher's books, had not previously demanded the money. At trial, Koehring maintained that the real reason why it had taken over Trencher was that the books were in bad shape (see II RT 1651-1652) but, since Koehring had been controlling the books, that justification sounded mighty peculiar too, especially when it had not been mentioned at the time of takeover.

Koehring elected its own board of directors, fired Hilgedick as president of the corporation, and installed as president Ron Mullins, who had just been hired by Koehring (RT 181; II RT 1373-1374) and had no experience running a business (RT 183; II RT 142, 664). Mullins's background was in financing and he took over collection of the accounts receivable. RT 362. Mullins's principal mission was to "collect what's out there as quickly as we can." II RT 1459. And he had one other assignment. As Lackenbauer explained it: "We wanted to make sure that

Pacific Trencher did not make payments to the affiliated companies, to Hilgedick Rental, to Pacific Manufacturing, or indeed repay any of the loans that Mr. Hilgedick had made to Pacific Trencher." II RT 1650. Steve Hilgedick was placed in charge of sales. RT 360; II RT 1639, 1646. All monies collected from the sale of a Koehring product were sent to Koehring. The entire amount went to Koehring no matter the amount actually owed by Trencher to Koehring on the particular machine. The amount sent to Koehring at times included the California sales tax collected from the consumer. RT 188-189, see also RT 360-361, 406.

While Mullins collected on the accounts receivable as quickly as he could, Hilgedick was induced to sell Koehring's product. Koehring controlled Pacific Trencher for about six months and, by the end of that time, Hilgedick had sold all of the more than $1.5 million in Koehring inventory. II RT 883. He did so from the hope that he would eventually regain control of his company which, moreover, owed him $450,000. RT 544. Hilgedick's expectations were misleadingly stimulated by Lackenbauer who falsely assured Hilgedick, from the start of the takeover, the Koehring had assumed control only to "help" him and had no intention of liquidating the business. RT 186, 189-190; II RT 832, 856, 869.

On December 9, 1980, Hilgedick wrote to Lackenbauer stating that he was revoking his personal guarantees. RT 189-90. Koehring's response was two-fold: (a) Koehring secretly attempted to reinstate its UCC-1 filing and, (b) Koehring urged Hilgedick to reinstate his guarantees. RT 190-191, 340-342, 366. Hilgedick refused unless his Pacific Trencher stock were returned to him. RT 199. Hilgedick also decided to seek financing to pay the Koehring debt. Hilgedick approached Howard Pickle, manager of the San Leandro Bank of America. Pickle

reviewed Pacific Trencher's financial statements and informed Hilgedick that the bank would loan enough money to pay the Koehring debt and give Trencher some operating capital. II RT 988. Janet O'Hanis, who was the office manager of Pacific Trencher (II RT 970), had accompanied Hilgedick to the bank, and when they returned to Pacific Trencher, she informed Ron Mullins about the deal. Mullins was furious. He told Hilgedick that Hilgedick had no authority to negotiate a loan and that "Tnis isn't your company, anymore." Mullins went to the phone and called Koehring. II RT 989. The next day, Bank of America withdrew its loan offer. II RT 987-990.

Although Lackenbauer was assuring Hilgedick that Koehring had no intention of liquidating Pacific Trencher, Lackenbauer, on December 22, 1980, sent a letter to his superior, Twombly (Koehring had been acquired by AMCA, II RT 1874-1984), stating that "the final decision to liquidate the distributorship will be made in January, pending audited financial statements and, more importantly, the finding of an alternative distribution." RT 365-366.

During this period, while falsely denying any intention to liquidate Pacific Trencher, Lackenbauer continually led Hilgedick to believe that Koehring was contemplating loaning further money to Pacific Trencher in order to insure its viability. As late as February of 1981, Lackenbauer, speaking at a Pacific Trencher corporate Board of Directors meeting, insisted that the "major impediment" to Koehring's extending further credit to Pacific Trencher was Hilgedick's refusal to reinstate his guarantees. RT 372; and see II RT 985-986.

During the latter fall and winter of 1980-1981, the business ventures allied with Pacific trencher, and Hilgedick himself, had their cash cut off. Pursuant to petitioners' directions, Pacific Trencher stopped paying

rend owed to Hilgedick on the property occupied by Pacific Trencher. Hilgedick Rentals was only paid money due it to the extent payments were necessary to keep machines from being repossessed by other creditors. No money was paid to Pacific Manufacturing for the trenchers that had been sold to Pacific Trencher. RT 184; 207, 211; 346-348; 439-441. Hilgedick was not paid his salary (RT 212), the only employee not being paid, nor was he paid commission on the equipment he was selling. II RT 877-879.

Pacific Manufacturing found itself undermined in its relationship with the Navy. It was low bidder on a $2.5 million Navy contract (RT 196; II RT 863) as well as a $4 million Navy contract with a 100% option, making it worth $7.7 million (RT 433; II RT 863); but the Navy, which had somehow discovered that the stock in Pacific Trencher had changed hands, wanted a reaffirmation of the guarantee from Trencher. The guarantee was simply a performance guarantee and required no pledge of collateral. RT 431, II RT 783. Though Lackenbauer was insisting that he had no intention of liquidating Pacific Trencher, he refused to permit Trencher to reaffirm the guarantee. This was so although Hilgedick offered to assign the contract to Koehring so that Koehring could take 10 percent of the contract from the top to pay off the debt. RT 192-193; II RT 865-866, 944, 986. Lackenbauer refused, giving no reason for his refusal. RT 192-196.

On April 14, 1981, when Hilgedick had sold all of Koehring's new product inventory, it was announced that Pacific Trencher's Koehring dealership was being suspended. RT 381. All parties agreed that there was no way, at this point, for Pacific Trencher to survive without the Koehring distributorship. RT 202-203, 522.

On April 15, 1981, no rent having been paid by Pacific Trencher to Hilgedick, Hilgedick served Pacific

Trencher with a 3-day notice to pay rent or quit. RT 203-204. The Koehring-controlled Pacific Trencher quit the premises in an utterly destructive manner. They fired all the employees and then hired three of the just-fired employees to move out equipment. II RT 936. Predictably, devastation followed. Theft and vandalism were rampant. Mullins was asked to control the situation but Mullins did not care about it. The destruction went on for three days with the doors unlocked at night. II RT 996-998. Trencher's ledgers disappeared (II RT 911, 1915), and, on April 22, 1981, petitioners put Trencher into bankruptcy. RT 389.

During the scene of destruction at Pacific Trencher, Miller delivered what has, so far, been a prophetic threat: "You know," Miller told Hilgedick, "you are never going to be able to afford this lawsuit." II RT 912. Earlier, Miller had said that Hilgedick would find himself in a legal battle he could not win and he would lose everything. II RT 994-995. Miller began to make his point rather vividly. In December of 1981, Hilgedick was served with a notice of default and election to sell under a deed of trust, signed by Miller, and claiming that Hilgedick owed Koehring $2.25 million. II RT 913-914. Hilgedick has no idea where the figure came from and Koehring has never explained it. II RT 914-915.

All of the businesses allied with Pacific Trencher were devastated and ultimately destroyed. Koehring put liens on Hilgedick's property, making it impossible for him to sell any property to generate cash. II RT 920-922. As to Pacific Manufacturing, there were no government contracts. Pacific Manufacturing was low-bidder on a $10 million contract but did not get it. II RT 918. Lockheed withdrew its business. II RT 918-919. Pacific Manufacturing closed its doors. II RT 923, 955. Hilgedick's competitors began using his patented patterns and forms to

make trenchers (II RT 924) but there was little he could do about it. Hilgedick Rental went out of business (II RT 924) and Hilgedick had to file a personal bankruptcy because of petitioners' liens on his property. II RT 921, 925-926.

Respondents' complaint, stating causes of action for, among other things, intentional interference with business relations and breach of contract, was filed in the Superior Court, Alameda County, State of California, on November 11, 1981. CT 2. No cross-complaint was filed by petitioners. Jury trial began on December 15, 1983. RT 9. On December 22, 1982, pursuant to stipulation of the parties, jury trial was waived on respondents' cause of action for breach of contract and the only cause of action submitted to the jury was that for intentional interference with business relations. RT 591-592. Pursuant to stipulation of the parties, the submission to the jury on the issue of damages was bifurcated, the jury being instructed, at first, on the issue of compensatory damages only. RT 597-598. On December 27, 1982, the jury returned its verdict in favor of respondents in the amount of $730,482.10 CT 753. The court then excused the jury but was reminded by respondents' counsel that there was still an issue to consider, at which time the court told the jury that it was not excused and that it had another issue it would have to consider. RT 683. The parties then stipulated to petitioners' net worth and also agreed that there would be neither evidence nor argument on the issue of exemplary damages, the jury simply to be instructed on the law of exemplary damages. The jury was given that instruction and returned a verdict in respondents' favor in the amount of $730,482.10, exactly replicating the amount of compensatory damages. CT 754.

On February 7, 1983, Judge Sutter, the judge to whom the breach of contract cause of action had been submitted

by stipulation, issued his tentative decision denying respondents relief. CT 879. Judge Sutter also made a ruling on a matter which had not been submitted to him and upon which no claim had been made. Judge Sutter found that respondents had injured petitioners and awarded petitioners damages in the amount of $1,986,000. CT 848. This ruling was later reversed by the California Court of Appeal. Petition, Appendix A, 19-21.

On May 6, 1983, Judge Sutter denied petitioners' motion for a new trial on liability but granted petitioners' motion for a new trial on the question of exemplary damages. CT 965-971. Judge Sutter ruled that there was no evidence to support exemplary damages which, of course, was literally true, since no evidence whatsoever had been introduced in the second part of the bifurcated trial.

Jury trial solely on the issue of punitive damages, pursuant to petitioners' successful motion for a new trial on that issue, began on April 21, 1987. II RT 637. On May 13, 1987, the jury returned its verdict in favor of respondents in the amount of $11 million. II RT 2982-2983. On August 14, 1987, Judge Eaton, trial judge at the second exemplary damages jury trial, ruled that the damages were excessive and reduced them by $2.5 million. II RT 2089-2142.

REASONS WHY THE WRIT SHOULD BE DENIED

I

FEDERAL QUESTIONS NOW RAISED BY PETITIONERS WERE NOT RAISED IN THE CALIFORNIA TRIAL COURT OR COURT OF APPEAL

A. Standards Which Petitioners Now Claim Are Vague Are The Very Standards By Which They Asked That The Jury Be Guided.

Though petitioners acknowledge, by omission, that they raised no federal Due Process questions in the trial

court (Petition, 7-8), they do not reveal that they requested, at trial, the very instruction they now claim contained constitutionally impermissible standards creating an "unfettered" jury. Petition, 12. The jury instruction submitted by petitioners is reproduced in Appendix A, *infra*, and, as will be seen, it, according to petitioners, contains language "virtually identical" to the instruction given at trial. Petition, 15 n.16.

Petitioners had no complaint about the jury instruction in the California Court of Appeal. For good reason. They could not, in California, ask for an instruction, receive it, and then challenge it on appeal. Litigants are not permitted to mine the trial with error of their own creation; thus even if the instruction requested by the litigant is legally faulty, no complaint will be heard on appeal. *Lynch v. Birdwell*, 44 Cal.2d 839, 846 (1955); *Jentick v. Pacific Gas and Elec. Co.*, 18 Cal.2d 117, 122 (1941).

It is, in California, error to refuse any relevant instruction that correctly states the law and is not encompassed within some other instruction. Petitioners were free, for example, to request that the jury be given a *Grimshaw* instruction. Had petitioners done so, the jurors would have been instructed to consider the:

> "Severity of threatened harm; degree of reprehensibility of defendant's conduct, profitability of the conduct, wealth of defendant, amount of compensatory damages (whether it was high in relation to injury), cost of litigation, potential criminal sanctions and other civil actions against defendant based on same conduct." *Grimshaw v. Ford Motor Co.*, 119 Cal.App.3d 757, 819 n.4 (1981).

Petitioners, in their Supplemental Brief, endorse these standards as curing any vagueness they perceive in the statute. Supplement. 3, n.2. That these standards are consistent with this Court's *Pacific Mutual Insurance Co. v. Haslip*, 59 LW 4157 (1991) decision goes without saying;

indeed, they are even satisfactory to the dissent. *Id.* at 4170 (O'Connor, J., dissenting).

The *Grimshaw* standards are part of the gloss of former California Civil Code § 3294. They were announced six years before petitioners submitted proposed jury instructions to the trial court. Petitioners could have had the jury instructed by the very standards they now call satisfactory by simply asking for them. Petitioners did not request *Grimshaw* instructions; instead they requested, and got, the instruction they now call vague. This is the vice of invited error in its most vivid form. No system of review can tolerate a strategy in which a litigant calls for an instruction, receives that instruction and, after the verdict, argues that the instruction it requested was wrong and that a different instruction, never requested, should have been given.

B. Petitioners' Due Process Claim In California's Appellate Courts Was, Because Not Raised At Trial, Confined To A Contention That The Statute Is Facially Unconstitutional.

Claims that California law violate the Due Process Clause of the Fourteenth Amendment must be raised in the trial court (*Kellis v. Ring*, 92 Cal.App.3d 854, 861 (1979)), a rule that this Court has previously acknowledged and respected. See, e.g., *Edelman v. California*, 344 U.S. 357 (1953). Petitioners raised no Due Process question in the trial court at either of the two punitive damages trials.

Having not raised the Due Process question in the trial court, California law foreclosed petitioners from presenting it in the Court of Appeal except to the extent they could narrow any Due Process claim to a purely legal question. California's appellate courts will consider and decide a legal question not raised in the trial court only when the appellant can demonstrate that the issue is

solely one of law that could not conceivably have been illuminated by any further development of the facts surrounding the transactions to which the legal standard is to be applied. *Ward v. Taggart*, 51 Cal.2d 736, 742 (1959); *Panopulos v. Maderis*, 47 Cal.2d 337, 341 (1956). But if the new legal question, and its relevance to the case at hand, may conceivably be illuminated by factual development, then the question is no longer deemed purely legal and the issue may not be raised, for the first time, on appeal. *Bogacki v. Board of Supervisors of Riverside Co.*, 5 Cal.3d 771, 780 (1971); *Parker v. City of Fountain Valley*, 127 Cal.App.3d 99, 117 (1981). In the Reply to Respondents' Request That Stay Pending Review on Certiorari Be Vacated (p. 7), petitioners affirmed that their challenge in the California appellate courts had been confined to a facial challenge, explaining to this Court the nature of their claim in the California courts as follows: "To begin with, it is proper to consider a constitutional question for the first time on appeal where, as here, it raises only issues of law and the public interest is involved."

Petitioners, then, because the question had not been raised in the trial court, were restricted, in the Court of Appeal, to a facial challenge to former California Civil Code § 3294. It is far from clear to us how, strictly as a procedural matter, former § 3294 could be vulnerable to facial challenge for "vagueness challenges to statutes which do not involve First Amendment freedoms must be examined in the light of the *facts* of the case at hand." *United States v. Mazurie*, 419 U.S. 544, 550 (1975). (Emphasis added); see also *United States v. Powell*, 423 U.S. 87, 92-93 (1975); *United States v. National Dairy Products Corp.*, 372 U.S. 29, 32-33, 36 (1963).

In any event, this Court's decision in *Pacific Mutual Life Insurance Co. v. Haslip, supra* (1991), leaves no room

for argument that former § 3294 is open to facial challenge. Facial unconstitutionality having been the only issue left to petitioners when they failed to raise a constitutional issue at trial, and facial constitutionality having been removed as an issue by *Pacific Mutual*, petitioners have no federal issue left.

C. Petitioners Did Not Challenge The Ratio Of Exemplary To Compensatory Damages As A Federal Question.

Though petitioners did, in the California courts, challenge the ratio of exemplary damages to compensatory damages as excessive, they did not do so as a *federal* question and they did not, therefore, jurisdictionally preserve it for consideration by this Court. *Beck v. Washington*, 369 U.S. 541, 549-550 (1961).[2]

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[2] Petitioners say that in addition to the imposition of exemplary damages that the imposition of tort liability cannot be squared with Due Process. Petition, p. 26. Petitioners have not, before now, ever claimed that the imposition of liability violated Due Process. No such claim was made in the California courts, trial or appellate, and, accordingly, the Presentation and Decision of the Federal Constitutional Questions (Petition, 7-9) is necessarily devoid of any appropriate citation to the record. As recently as their Reply to Respondent's Request that Stay Pending Review on Certiorari Be Vacated (p. 5), petitioners denied that they were seeking any stay of the liability portion of the judgment. Because petitioners do not even have a colorable (or intelligible) federal claim regarding the liability judgment, we do not intend to respond to this unexplained challenge. Solely to dispense some of the smoke, we make the following observations:

It is not true, as petitioners say, that their conduct was "lawful". Petition, 3. They engaged in an intentional tort and that is not lawful conduct. The contractual arrangements

(Continued on following page)

II

THE JURY INSTRUCTION WAS NOT CONSTITUTIONALLY INFIRM

The Petition does not tell this Court exactly what the jury instruction was, petitioners preferring, for whatever reasons, to furnish this Court with a truncated version of the standard instruction (Petition, 15 n. 16) rather than the instruction actually given. Likely this inattention to what actually occurred is simply a reflection of petitioners having preserved only a facial constitutional challenge to former California Civil Code § 3294. When a statute is challenged on its face, what in fact occurred is beside the point. Whatever the event, here is the instruction actually given:

> "Plaintiffs have already been awarded damages sufficient to compensate them for any and all legally compensable injuries incurred as a result of Defendants' actions which are the subject of this lawsuit. You are to consider whether or not you should award additional damages against the Defendants, called punitive damages, only for the sake of example and by way of

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(Continued from previous page)

between the parties is, under California law, pertinent only to the degree that it supports the defense of justification or privilege and it is a factual question. At the liability trial, petitioners introduced no testimony contending that their conduct was justified or motivated by their contractual arrangements with respondents. Additionally, petitioners stipulated that the jury instruction regarding the standard of intentional interference with business relations was a correct statement of the law. RT 640. At the second exemplary damages trial, the jury was instructed that the contractual arrangements between the parties were lawful agreements. II RT 2073.

punishment. You may in your discretion award such damages, if, but only if, you find that a preponderance of the evidence that said Defendants were guilty of malice or oppression in the conduct on which the prior jury based its finding of liability.

'Malice' means conduct which is intended by the Defendant to cause injury to the Plaintiff or carried on by the Defendant with a conscious disregard for the rights of others. A person acts with conscious disregard of the rights of others when he is aware that his conduct will probably result in a violation of the rights of others and willfully and deliberately fails to avoid that consequence.

'Oppression' means subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights.

If you determine that punitive damages should be awarded, the law provides no fixed standards as to the amount of punitive damages you may award, but leaves that amount to the jury's sound discretion, exercised without passion or prejudice.

In arriving at any award of punitive damages, you are to consider the following:

The reprehensibility of the conduct of the Defendant;

The amount of punitive damages which will have a deterrent effect on the Defendant in the light of Defendants' financial condition;

That the punitive damages must bear a reasonable relationship to the actual damages.

You have been told and I'll tell you again that the actual damages awarded by the prior jury as compensation for the injuries were as follows – there are three Plaintiffs. That hasn't been clear in this case, but there are three separate Plaintiffs and that will show that on the verdict forms.

> In the prior action the jury awarded Plaintiff Steven K. Hilgedick $42,000. The jury awarded the Plaintiff Pacific Manufacturing Company $426,000; and awarded Plaintiff Hilgedick Rentals $261,682.10; for a total judgment against the Defendants in favor of the three Plaintiffs of $730,482.10.
>
> Now, you have been advised that Plaintiffs have declared bankruptcy. You have been advised that the Defendants have asserted a claim against the Plaintiffs in that bankruptcy proceeding. The validity of the Defendants' claim in the bankruptcy proceeding and the amount of that claim are in dispute and will be decided by the Bankruptcy Court in a proceeding in that court.
>
> As a result, if you find that Plaintiffs are entitled to an award of punitive damages, you are not to consider that Defendants have a claim in Plaintiffs' bankruptcy proceeding in making a decision as to the amount of punitive damages to be awarded. This court will make an appropriate adjustment as required by law to take into consideration Defendants' claim against the Plaintiff in the bankruptcy proceeding. II RT 2074-2076.

By any rational measure, the above-instruction guided the jury with a great deal more precision, or to use petitioners' locution, "fettered" (Petition, 12) the jury, a good deal more than the Alabama instruction at issue in *Pacific Mutual Life Insurance Co. v. Haslip, supra* 4158, n.1. First of all, the above instruction mandates not only that the jury focus its attention on wrongdoing but that the jury make a factual finding that a special form of wrongdoing has occurred *before* turning its attention to damages or exercising any discretion concerning the amount of damages. The jury in the instant case was expressly instructed that exemplary damages could only be

imposed if, in addition to the commission of the intentional tort, the jury should find that petitioners had acted with malice or oppression. Thus "you may in your discretion award such damages, if, but only if, you find that by a preponderance of the evidence that said Defendants were guilty of malice or oppression. . . ." Both malice and oppression were then defined, malice meaning the jury had to find that, in addition to the commission of the intentional tort, petitioners intended to cause injury to respondents or that their conduct was pursued with a conscious disregard of respondents' rights; oppression meaning the jury had to find that in addition to committing the intentional tort, petitioners subjected respondents to cruel and unjust hardship in conscious disregard of respondents' rights. The Alabama instruction, by contrast, permitted imposition of punitive damages, in the jury's total discretion, solely on the basis of the occurrence of the tort with no requirement that the jury, anterior to considering punitive damages, find any additional element or form of wrongdoing.

After defining malice and oppression, the above-instruction again emphasizes that there must be a threshold finding of malice or oppression before any amount of exemplary damages can be considered ("If you determine that punitive damages shall be awarded") and, following that admonition, the jury is told that although there is no precise dollar amount set by law ("the law provides no fixed standards as to the amount of punitive damages you may award") that, as to the amount of exemplary damages, they are to exercise "sound" discretion "without passion or prejudice."

By contrast, the Alabama jury was simply instructed that imposition of exemplary damages was "entirely discretionary" without a distinction even being drawn

between the discretion to impose damages and the discretion to decide the amount of damages. There was no admonition that discretion was to be exercised soundly, dispassionately and without prejudice.

After directing that exemplary damages may be awarded only if the jury first finds oppression or malice and that the jurors are to exercise their discretion soundly, without passion or prejudice, in determining the amount of any damages, the above-instruction tells the jurors that, in arriving at any award of exemplary damages they are, first of all, to focus their attention, once again, on the wrongdoing of petitioners. "The reprehensibility of the conduct" is the first element to be considered. Thus, after the threshold finding of malice or oppression, reprehensibility enters the picture as a measure of damages. Next, the above-instruction tells the jurors that the amount of exemplary damages should be such as will have a deterrent effect on petitioners in light of their financial condition. Finally, the jury is told that the punitive damages must bear a reasonable relationship to the compensable damages and, in order to reemphasize that point, the instruction reiterates the amount of damages assessed on liability ("You have been told and I will tell you again"). By contrast, the Alabama instruction mentioned reprehensibility not at all but rather the "character and degree of the wrong" and did not expressly mention deterrence but only the "necessity of preventing similar wrong." The Alabama instruction does not direct attention to the defendant's financial condition and it does not direct the jury to consider the relationship of any exemplary damages it may award to the compensable damages.[3]

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[3] Although the Alabama jury was not directed to consider the financial condition of the defendant, it is apparently a

(Continued on following page)

In sum, the above-instruction includes every element of the Alabama instruction, but with greater precision and emphasis and with greater restraints on the exercise of discretion. The above-instruction, moreover, contains additional guidelines including a threshold factual finding of wrongdoing (malice or oppression) before a jury may even consider, much less exercise, discretion regarding an amount of exemplary damages; and, unlike Alabama, the above-instruction required that the exemplary damages bear a reasonable relationship to the compensatory damages.

III

THE RELATIONSHIP OF EXEMPLARY TO PUNITIVE DAMAGES IS REASONABLE AND WAS THOROUGHLY CONSIDERED AND REVIEWED PURSUANT TO STANDARDS WHICH PETITIONERS REQUESTED

Petitioners' Supplemental Brief tells us that exemplary damages awards should pass constitutional muster only where appellate review is available pursuant to

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(Continued from previous page)

matter to be considered on appellate review when damages are challenged as excessive. See *Pacific Mutual*, at 4162. In California, consideration of evidence on appeal is restricted to the record at trial and thus, absent trial evidence of financial position it would be impossible for an appellate court to assess financial position. Petitioners, in their Supplemental Brief, tout appellate consideration of financial position as a virtue that should be constitutionally required. Supplement, 3, n.2. Petitioners did, in fact, receive that appellate consideration and it was possible only because financial position evidence was introduced at trial.

"Detailed substantive standards." Supplement, 3. Petitioners then reveal the detailed substantive standards they have in mind:

> The Alabama Supreme Court first announced these standards in *Green Oil Co. v. Hornsby*, 539 So.2d 218, 224-225 (Ala. 1989). There, the court directed courts to consider the following factors in reviewing the awards of punitive damages: (a) the relationship between the punitive damages award and the harm likely to result from the defendant's conduct as well as the harm that actually has occurred; (b) the reprehensibility of the defendant's conduct, the duration of that conduct, the defendant's awareness, any concealment, and the existence and frequency of similar past conduct; (c) the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss; (d) the defendant's "financial position"; (e) the costs of litigation; (f) the imposition of criminal sanctions on the defendant for its conduct, to be taken in mitigation; and (g) the existence of other civil awards against the defendant for the same conduct, also to be taken in mitigation." Supplement, 3 n.2.

That the standards are cribbed from this Court's *Pacific Mutual* (at 4162) decision, where they are not featured as a constitutional model, in no way diminishes their value to respondents who have, until the Supplemental Brief, had nothing with which to grapple but petitioners' belated claim that there are some phantom "standards" unrecognized by California. Finally there is something to contest. And, it turns out, a contest is unnecessary. These "detailed substantive standards" do not have their provenance in 1989 Alabama, but 1981 California. To Californians, they have become as familiar as an old shoe; we call them *Grimshaw* standards. In *Grimshaw v. Ford Motor Co., supra* at 819, n.14 (1981), the

Court of Appeal, in sustaining an exemplary damages award of $3.5 million dollars, held that "the amount of the award as reduced by the judge was reasonable under the suggested factors, including the factor of any other potential liabilities, civil or criminal." The "suggested factors" by which the review had been conducted were:

> "Severity of threatened harm; degree of reprehensibility of defendant's conduct, profitability of the conduct, wealth of defendant, amount of compensatory damages (whether it was high in relation to injury), cost of litigation, potential criminal sanctions and other civil actions against defendant based on same conduct."

If petitioners did not receive *Grimshaw* review it is because petitioners did not request *Grimshaw* review. All that was required of petitioners, in California's appellate courts, was that they request *Grimshaw* review and indicate, by appropriate reference to the record, in what way the judgment should be deemed unreasonable pursuant to *Grimshaw* standards. Petitioners did not do that. The truth is that petitioners have never, at any time, asked for any review, from any court, that would focus on the material facts of this case. Petitioners, in the trial court, following verdict; in the California Court of Appeal; in their petition to the California Supreme Court; and in their Petition and Supplemental Brief here have really had but one point: that the exemplary damages do not bear a reasonable relationship to the compensatory damages and that, as a matter of law, quite apart from the facts of the case, an 11 to 1 ratio violates some unspecified (natural law?) standard. Petition, 24; Supplement, 6.

The relationship, in this case, of the exemplary damages to the compensatory damages has been considered at the state level on four separate occasions. First of all

the jury, which imposed the exemplary damages, considered the relationship to compensable damages. The jury was instructed that any exemplary damages it might impose must bear a reasonable relationship to the compensatory damages and the jurors, moreover, were expressly reminded as to the amount of compensable damages. After the jury verdict, petitioners argued to the trial judge that the exemplary damages did not bear a reasonable relationship to the compensable damages. The trial judge, who had the advantage of having heard all the evidence in the case, thoroughly reviewed petitioners' contention and did, indeed, reduce the verdict by $2.5 million. The trial judge did so based on a theory which petitioners had not advanced. II RT 2129. It is difficult to imagine a stronger demonstration of just how thorough and dispassionate a review petitioners have had from the California judiciary. Following the trial judge's review of the jury's consideration, petitioners argued, in the Court of Appeal, that the exemplary damages, as reduced by the trial judge, were not reasonably related to the compensatory damages. After thorough review, the Court of Appeal issued a 70 page opinion in which the justices unanimously concluded that the exemplary damages bore a reasonable relationship to the compensatory damages. Petitioners then asked the California Supreme Court to hear the case and find that the relationship of exemplary to compensatory damages was not reasonable and, after review, not one justice of the California Supreme Court voted to hear petitioners' case. Now, how much review of the damages-relationship issue are petitioners supposed to receive? Four separate considerations would seem ample.

Whether exemplary damages bear a reasonable relationship to compensatory damages is not a question of mathematics. The reasonableness of the relationship turns

on the facts of the case. In some cases a ratio of 2 to 1 will be unreasonable; in other cases a ratio of 100 to 1 will be reasonable. All the compensatory damages sustained by petitioners were out-of-pocket and the 11 to 1 ratio is, compared with the 200 to 1 ratio sustained by this court in *Pacific Mutual* (at 2163), rather modest. In determining whether the relationship is reasonable, moreover, California Courts examine all injury actually inflicted by the wrongdoer.

The amount of exemplary damages awarded in the instant case is, in truth, less than the actual injury inflicted by petitioners. Compensatory damages, in California, are a very austere matter, severely restricted by considerations such as standing and immediacy. These restrictions do not, however, control analysis when exemplary damages are challenged as excessive. In that situation, the California Courts look to the complete and actual losses of the victim. See, e.g., *Neal v. Farmers Ins.*, 21 Cal.3d 910, 929 (1978); *Pusateri v. E.F. Hutton Co., Inc.*, 180 Cal.App.3d 247, 249-50 (1986).

The injury suffered individually by respondent Steve Hilgedick is good illustration of the point. Hilgedick, as an individual, recovered compensatory damages in the amount of $42,000, which represented the rent that petitioners prohibited Pacific Trencher from paying to Hilgedick. Only $42,000 was directly attributable to the tort of intentional interference. But the injury inflicted by petitioners' malicious course of conduct greatly exceeded $42,000. Hilgedick, at the time the scheme to destroy him began, had a personal worth of about $4.5 million (II RT 915) and Pacific Trencher, additionally, owed him $450,000. RT 544. But for the conduct of petitioners, none of this nearly $5 million would have been lost.

There is also Pacific Trencher to consider. Pacific Trencher, the year before petitioners began to exercise

control over it, grossed nearly $11 million (RT 105) and provided the community with over 100 jobs. RT 82; II RT 787. Petitioners, as part of their scheme to destroy Hilgedick, took over Pacific Trencher and, at the time it was plunged into bankruptcy, petitioners, not respondents, had control of the Pacific Trencher stock. Under California law, therefore, respondents had no standing to assert this grievous loss to them personally as well as their community. But there is no constitutional reason why California's standing laws could not be different and there is, therefore, no constitutional reason why, when reviewing the appropriateness of the exemplary damages, the California courts cannot take into account this damage actually inflicted by petitioners in their malicious course.

And there is also the actual loss to respondent Pacific Manufacturing which, at the time petitioners began their destructive scheme, looked to be an even more promising business than Pacific Trencher. Because of petitioners' interference, Pacific Manufacturing lost a Navy contract, on which it was low-bidder, worth $7.7 million. II RT 863. Shortly thereafter Pacific Manufacturing was again low-bidder, on a $10 million contract, but did not get it. II RT 918. Instead, because of petitioners' interference, Pacific Manufacturing closed its doors and went out of business. II RT 924. Pursuant to California's compensatory damages law, these multi-million dollar losses were deemed too speculative to permit recovery as intentional interference damages. But there could be no constitutional impediment to California modifying its standards as to what damages are sufficiently certain to justify recovery and there cannot, therefore, be any constitutional impediment to including these sums in the exemplary damages calculus. There is more, including the destruction of Hilgedick Rental, which had been grossing $1 million a

year (RT 85), but it boils down to this: the exemplary damages do not come close to matching the actual damage inflicted.

And why did petitioners inflict all this damage? For no reason except to cover their own tracks when, through their own negligence, they lost their security interest in the assets of Pacific Trencher. And petitioners maintained this malicious course over a six-month period, all the while deluding Hilgedick into selling more than $1.5 million of their product. II RT 883.

There is nothing unreasonable about the amount of exemplary damages imposed on petitioners.

CONCLUSION

Petitioners requested the jury instruction they now question and did not raise the ratio of exemplary to compensatory damages as a federal question in the California courts; their Petition is, therefore, jurisdictionally infirm. And petitioners' constitutional objections, even were they cognizable, are meritless.

Respondents respectfully urge that the Petition be denied and the stay vacated.

Dated: March 29, 1991

Respectfully submitted,

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APPENDIX

DEFENDANTS' PROPOSED JURY INSTRUCTION NO. 17

(Measure of Punitive Damages)

The law provides no fixed standards as to the amount of punitive damages, but leaves the amount to the jury's sound discretion, exercised without passion or prejudice.

In arriving at any award of punitive damages, you are to consider the following:

(1) The reprehensibility of the conduct of the defendant,

(2) The amount of punitive damages which will have a deterrent effect on the defendant in the light of defendant's financial condition,

(3) That the punitive damages must bear a reasonable relation to the actual damages.

If you find that plaintiff is entitled to an award of punitive damages against defendant, you shall state the amount of punitive damages separately in your verdict.

Given ___

Refused ___

Given as modified ___

Withdrawn ___

_____

Judge of the Superior Court

Based on the last three paragraphs of California Jury Instructions (BAJI) (7th Ed. 1986) No. 14.71, which address the measure of punitive damages.

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No. 90-1369

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

AMCA INTERNATIONAL FINANCE COMPANY, et al.,
Petitioners,

vs.

STEVEN K. HILGEDICK, etc., et al.,
Respondents.

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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RULE 29.1 NOTICE

The list of parent companies and affiliates of petitioners is set forth in the petition for a writ of certiorari.

TABLE OF CONTENTS

	Page
RULE 29.1 NOTICE	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
PRELIMINARY STATEMENT	1
ARGUMENT	3
I	
PETITIONERS' CONSTITUTIONAL CHALLENGES TO CALIFORNIA'S PUNITIVE DAMAGES SCHEME, AND TO THE PUNITIVE DAMAGES AWARD IN THIS CASE, ARE PROPERLY BEFORE THIS COURT	3
II	
THE PUNITIVE DAMAGES AWARD IS CONSTITUTIONALLY INFIRM BECAUSE (A) IT WAS IMPOSED IN THE ABSENCE OF MEANINGFUL PROCEDURAL SAFEGUARDS; AND (B) IT IS EXCESSIVE AS A MATTER OF SUBSTANTIVE DUE PROCESS	7
CONCLUSION	10

TABLE OF AUTHORITIES

Cases

Page

Bertero v. National General Corp., 13 Cal.3d 43, 118 Cal.Rptr. 184, 529 P.2d 608 (1974) 4

Bogacki v. Board of Supervisors, 5 Cal.3d 771, 97 Cal.Rptr. 657, 489 P.2d 537 (1971) 4-5

Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., 155 Cal.App.3d 381, 202 Cal.Rptr. 204 (1984) 8

Gordon v. Strawther Enterprises, Inc., 273 Cal.App.2d 504, 78 Cal.Rptr. 417 (1969) 3

Grimshaw v. Ford Motor Co., 119 Cal.App.3d 757, 174 Cal.Rptr. 348 (1981) 8

Kellis v. Ring, 92 Cal.App.3d 854, 155 Cal.Rptr. 297 (1979) 4

Masterson v. Pig'n Whistle Corp., 161 Cal.App.2d 323, 326 P.2d 918 (1958) 4, 6

Moradi-Shalal v. Fireman's Fund Ins. Companies, 46 Cal.3d 287, 250 Cal.Rptr. 116, 758 P.2d 58 (1988) 4

New Jersey v. Portash, 440 U.S. 450 (1979) 5

Pacific Mutual Life Insurance Co. v. Haslip, 59 U.S.L.W. 4157 (March 4, 1991) 2, 7, 8, 9

Parker v. City of Fountain Valley, 127 Cal.App.3d 99, 179 Cal.Rptr. 351 (1981) 5

People v. Turner, 50 Cal.3d 668, 268 Cal.Rptr. 706, 789 P.2d 887 (1990) 4

Raley v. Ohio, 360 U.S. 423 (1959) 5

Rosener v. Sears, Roebuck & Co., 110 Cal.App.3d 740, 168 Cal.Rptr. 237 (1980) 8

Stanley v. Illinois, 405 U.S. 645 (1972) 6

Trammell v. Western Union Tel. Co., 57 Cal.App.3d 538, 129 Cal.Rptr. 361 (1976) 3

Williamson v. Pacific Greyhound Lines, 93 Cal.App.2d 484, 209 P.2d 146 (1949) 4

Winkler v. So. Cal., etc. Medical Group, 141 Cal.App.2d 738, 297 P.2d 728 (1956) 6

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VS.

STEVEN K. HILGEDICK, etc., et al.,
Respondents.

REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

PRELIMINARY STATEMENT

Respondents' brief is notable for what it does *not* say. While conceding that the parties' contracts were valid and lawful, respondents fail to explain how a multimillion dollar punitive damages award that was imposed on the basis of conduct that appeared to be permitted by the express terms of those contracts can comport with due process. Instead, respondents urge this Court to deny review on the ground that the questions presented in the petition were not properly raised below.

There is no merit to any of respondents' waiver arguments. Under California law, petitioners' "defensive" submission of an abstractly correct punitive damages instruction, in accordance with the trial court's refusal to take the issue of punitive damages from the jury, does not preclude petitioners from challenging that instruction on appeal. Nor, as a matter of state law, were petitioners required to raise their constitutional challenges to California's

punitive damages system in the trial court. These issues were briefed and argued in the California Court of Appeal, which ruled against petitioners on the merits, and they were presented to the California Supreme Court, which declined to grant review. Hence, these issues are properly before this Court.

Respondents' arguments as to why this Court should deny the petition on the merits also fail. Despite respondents' misleading discussion of California's standards for reviewing punitive damages awards, the fact is that the deferential "passion and prejudice" review conducted by the California Court of Appeal in this case provided little, if any, protection against unchecked jury discretion. In any event, regardless of the procedures followed by the jury and the courts in this case, imposition of an $8.5 million punitive damages award on the basis of conduct that appeared to be permitted by the express terms of lawful and valid contracts simply cannot be squared with the requirement of *Pacific Mutual Life Insurance Co. v. Haslip,* 59 U.S.L.W. 4157, 4162 (March 4, 1991) that punitive damages be "reasonable in their amount and rational in light of their purpose to punish what has occurred and to deter its repetition."[1]

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[1] Respondents present a lengthy and largely irrelevant "statement of the case," the thrust of which is that petitioners engaged in deliberate "mismanagement" of Pacific Trencher to benefit themselves and "destroy" respondents. *See* Resp.Br., pp. 1-14. However, the issue of alleged bad faith mismanagement of Pacific Trencher was a part of respondents' challenge to the validity of the security documents, and that issue was submitted to the trial judge who decided *against respondents* in all respects. Pet.Cert., App. D, pp. 5-9. That finding was expressly affirmed by the California Court of Appeal. Pet.Cert., App. A, pp. 21-23.

As respondents concede (Resp.Br., p. 13), the only cause of action submitted to the jury was that for interference with their contractual relations with Pacific Trencher. That cause of action pertained to the claim that petitioners' exercise of their various contract rights (*i.e.*, withholding rental payments to Steven Hilgedick, withholding equipment rentals to Hilgedick Rental, and refusal to guarantee Pacific Manufacturer's government contract) was tortious under California law. *See* RT I 193-194, 202-203, 211, 347; Pet.Cert., App. A, pp. 9, 12-16. Those acts provided the basis for tort liability in this case.

ARGUMENT

I

PETITIONERS' CONSTITUTIONAL CHALLENGES TO CALIFORNIA'S PUNITIVE DAMAGES SCHEME, AND TO THE PUNITIVE DAMAGES AWARD IN THIS CASE, ARE PROPERLY BEFORE THIS COURT.

Respondents advance several contentions in support of their claim that petitioners' constitutional challenges were not properly raised below. Resp.Br., pp. 14-18. None has merit.

First, respondents claim that, by requesting an instruction embodying an abstractly correct statement of California's traditional standards for determining punitive damages, petitioners have "invited [any] error" and are now foreclosed, as a matter of California law, from raising a constitutional challenge to those standards on appeal. Resp.Br., pp. 14-16. Respondents are incorrect. Petitioners have consistently maintained throughout this case that the evidence did not support an award of punitive damages, and they unsuccessfully sought to take the issue of punitive damages from the jury by motions for directed verdict and for judgment notwithstanding the verdict.[2] Petitioners proposed the instruction in question only when their attempts to obtain judgment as a matter of law on the punitive damages claims failed and it had become obvious that further objection would have been unavailing. In view of these facts, petitioners were permitted, as a matter of California law, to submit a

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[2] The judge who presided at the first trial ruled that there was *no* substantial evidence of malice or oppression, but he denied petitioners' motion for judgment notwithstanding the verdict as to punitive damages under the mistaken impression that to grant the motion would violate the "single final judgment" rule. CT 974, 977. Under California law, however, a trial judge has power to grant judgment notwithstanding the verdict as to portion of a verdict not supported by substantial evidence (*Gordon v. Strawther Enterprises, Inc.*, 273 Cal.App.2d 504, 515-516, 78 Cal.Rptr. 417 (1969)), including an unsupported award of punitive damages (*Trammell v. Western Union Tel. Co.*, 57 Cal.App.3d 538, 543, 556-558, 129 Cal.Rptr. 361 (1976)).

defensive instruction setting forth the state law without a waiver of the right to raise constitutional challenges in the higher courts:

> "It is settled that where a party is unable to induce the court to accept his view of the law, the fact that he requests instructions in accordance with the court's ruling does not preclude him from assigning error." *Masterson v. Pig'n Whistle Corp.*, 161 Cal.App.2d 323, 336, 326 P.2d 918 (1958); *accord, People v. Turner*, 50 Cal.3d 668, 704-705, n. 18, 268 Cal.Rptr. 706, 789 P.2d 887 (1990); *Williamson v. Pacific Greyhound Lines*, 93 Cal.App.2d 484, 487, 209 P.2d 146 (1949).

Contrary to respondents' contention (Resp.Br., pp. 16-17), petitioners have not waived their constitutional challenges to California's punitive damages scheme by failing to raise them in the trial court. Indeed, it would have been an idle act to assert such arguments because the California Courts of Appeal and the California Supreme Court have repeatedly rejected both federal and state due process attacks on California's punitive damages statute. *See, e.g., Bertero v. National General Corp.*, 13 Cal.3d 43, 66, n. 13, 118 Cal.Rptr. 184, 529 P.2d 608 (1974). Under these circumstances, petitioners were not required to raise their constitutional challenges in the trial court as a matter of state law. *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 46 Cal.3d 287, 292, n. 1, 250 Cal.Rptr. 116, 758 P.2d 58 (1988) (defendant was not required to raise issue in lower courts because "clearly it was pointless for defendant to ask either the trial or appellate court to overrule one of our decisions").[3]

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[3] None of the cases cited by respondents (Resp.Br., pp. 16, 17) suggests that a litigant must first ask the trial court to rule contrary to established precedent before challenging that precedent in the higher courts. In *Kellis v. Ring*, 92 Cal.App.3d 854, 860-861, 155 Cal.Rptr. 297 (1979), the court noted that the constitutional question had been tardily raised but discussed the issue anyway and rejected it on the merits. The other California cases cited by respondents merely stand for the proposition that a party normally will not be allowed to change his theory of recovery on appeal where the new theory requires resolution of "controverted factual questions." E.g., *Bogacki v. Board of Supervisors*, 5 Cal.3d 771, 780, 97 Cal.Rptr. 657, 489 P.2d 537 (1971) (factual

In any event, petitioners' due process challenge to California's punitive damages scheme and to the punitive damages instruction in this case was briefed and argued in the California Court of Appeal, and that court addressed, and rejected, petitioners' constitutional arguments in its opinion. *See* Pet.Cert., App. A, pp. 41-43. "There can be no question as to the proper presentation of a federal claim when [the court below] passes on it." *Raley v. Ohio*, 360 U.S. 423, 436 (1959); *accord, New Jersey v. Portash*, 440 U.S. 450, 455 (1979).[4]

Also without merit is respondents' contention that petitioners never raised the question whether the punitive damages were unconstitutionally excessive as a matter of federal law. *See* Resp.Br., p. 18. Indeed, the manner in which petitioners framed this issue for the California Supreme Court could not have been clearer.[5] Thus, respondents are in all respects wrong in their

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question whether employee had been discharged for exercising free speech rights); *Parker v. City of Fountain Valley*, 127 Cal.App.3d 99, 116-117, 179 Cal.Rptr. 351 (1981) (factual question whether hearing officer was biased against discharged city employee in administrative proceeding for reinstatement).

[4] Respondents are incorrect that "[p]etitioners had no complaint about the jury instructions in the California Court of Appeal." Resp.Br., p. 15. To the contrary, petitioners argued that the punitive damages instruction was "vague and indefinite", and that the law upon which the instruction is based gave "no warning to defendants of the consequences of their acts." App.Opn.Br., p. 31, n. 13. Moreover, petitioners joined in the argument by Amicus Curiae, the Northern California Association of Defense Counsel, that the punitive damages instructions given in this case and in California generally were unconstitutionally vague. App.Reply Br., p. 25; *see* NCADC Amicus Br., pp. 14-21.

[5] "Do the Due Process Clauses of the California and United States Constitutions place an outer limit on awards of punitive damages that are grossly disproportionate to the harm caused and far in excess of any amount necessary to punish and deter." Pet.Rev., p. 2; *see id.* at 25-27.

assertions that petitioners have waived their constitutional challenges to the punitive damages award.[6]

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[6] Respondents correctly note that the third issue presented in the petition—whether the imposition of tort liability in this case violates due process—was not specifically raised below. Resp.Br., p. 18, n. 2. However, issues pertaining to the imposition of tort liability were raised, as were issues pertaining to due process requirements of notice prior to the imposition of liability for punitive damages. Hence, even though the precise issue was not previously argued, this Court may "dispose of the case on the constitutional premise raised below, reaching the result by a method of analysis readily available to the state court." *Stanley v. Illinois,* 405 U.S. 645, 658, n. 10 (1972).

Respondents' discussion of the merits of this question (Resp.Br., pp. 18-19, n. 2) requires only brief comment. First, respondents misstate petitioners' position. The issue presented is not whether petitioners' conduct was "lawful" under state law. Rather, the issue is whether a state may impose tort liability for conduct that appears to be permitted by lawful contracts between the parties "where the state law in effect when the conduct occurred gave no warning that such conduct was prohibited." Pet.Cert., p. 3. Respondents admit that the contracts in issue were lawful (Resp.Br., p. 19, n. 2), and there was no evidence that petitioners, at the time they exercised their contract rights, had any notice that those acts might be determined by a jury to be wrongful under California law. That petitioners stipulated that the liability instructions contained a correct statement of California law (*see* Resp.Br., p. 19, n. 2) is irrelevant. As noted above (pp. 3-4), under California law, a "defensive" stipulation that an instruction correctly states the law does not waive an objection that the instruction is inapplicable under the facts of the case. Neither does it preclude the agreeing party from arguing that there is no basis for the imposition of liability. *Masterson v. Pig'n Whistle Corp., supra,* 161 Cal.App.2d at 336; *Winkler v. So. Cal., etc. Medical Group,* 141 Cal.App.2d 738, 746, 297 P.2d 728 (1956).

II

THE PUNITIVE DAMAGES AWARD IS CONSTITUTIONALLY INFIRM BECAUSE (A) IT WAS IMPOSED IN THE ABSENCE OF MEANINGFUL PROCEDURAL SAFEGUARDS; AND (B) IT IS EXCESSIVE AS A MATTER OF SUBSTANTIVE DUE PROCESS.

Respondents argue that the instructions given in this case "guided the jury with a great deal more precision" than the instruction at issue in *Pacific Mutual,* and that therefore the massive award of punitive damages inflicted on petitioners passes constitutional muster. Resp.Br., pp. 19-24. Respondents' argument is fundamentally flawed.[7] In *Pacific Mutual,* the punitive damages award survived scrutiny largely because it had been subjected to rigorous review by the trial court and, more importantly, by the Alabama Supreme Court. "This appellate review ma[de] certain that the punitive damages [were] reasonable in their amount and rational in light of their purpose to punish what has occurred and to deter its repetition." 59 U.S.L.W. at 4162.

By contrast, in the present case, and in California generally, appellate courts review punitive damages awards by considering

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[7] The validity of respondents' premise—that the jury instructions in the present case adequately constrained the jury's discretion in determining how large an award to impose—is also flawed. The jurors in this case were told that there were "no fixed standards" to follow in setting the amount of punitive damages, and that they were simply "to consider" three factors in determining how large a sanction was appropriate. RT II 2075; *see* Pet.Supp.Br., App. A. Petitioners have already explained why these vague and subjective factors failed to provide a constitutionally adequate limit on the jury's power to punish. Pet.Cert., pp. 14-18. We see no need to repeat these points here.

Respondents contend, however, that the instructions limited the jury's ability to determine the amount of a punitive damages award by telling the jurors that they could award such damages only if they found petitioners had acted with malice or oppression. Resp.Br., pp. 21-22. Respondents miss the point. Requiring the jury to find evidence of a particular mental state as a prerequisite to awarding *any* punitive damages does nothing to constrain the jury's discretion to determine the *size* of such an award.

the same vague and open-ended factors that juries apply in awarding such damages in the first place; namely, the "reprehensibility" of the defendant's conduct, the defendant's financial condition, and whether the ratio between the compensatory and punitive damages is "reasonable." *See Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc.*, 155 Cal.App.3d 381, 387-388, 202 Cal.Rptr. 204 (1984); *Rosener v. Sears, Roebuck & Co.*, 110 Cal.App.3d 740, 750-752, 168 Cal.Rptr. 237 (1980). Moreover, the power of California appellate courts to control undue jury discretion is limited by the deferential "passion and prejudice" standard of review which, as this Court recognized in *Pacific Mutual* (59 U.S.L.W. at 4162, n. 10), provides an inadequate safeguard against excessive punitive damages.

Respondents apparently recognize the deficiencies in California's system of appellate review because they erroneously assert that, in reviewing punitive damages awards, California courts regularly apply a set of substantive standards—which respondents denominate the "*Grimshaw* standards"—that are supposedly akin to the standards applied by the Alabama Supreme Court in *Pacific Mutual*. Resp.Br., pp. 25-27; *see also, id.* at 15, 16. This is simply not true. The so-called "standards" are suggested by a law review article cited in a footnote in *Grimshaw v. Ford Motor Co.*, 119 Cal.App.3d 757, 819, n. 14, 174 Cal.Rptr. 348 (1981). They were not adopted as a test in *Grimshaw* and *no reference to them has been made in any other reported California appellate decision.*[8] To claim that petitioners could have received the benefit of these "standards" simply by asking for them is disingenuous at best.

Even if this Court were to conclude that the procedures followed by the jury and reviewing courts in this case were not constitutionally deficient, there remain for decision the questions whether the Due Process Clause imposes substantive constraints on the size of punitive damages awards in civil cases, and whether

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[8] Indeed, the terms "*Grimshaw* review," "*Grimshaw* standards" and "*Grimshaw* instruction" that respondents declare to be "as familiar as an old shoe" (Resp.Br., p. 25; *see also, id.* at 15, 26) do not appear in *any* reported judicial opinion in California.

the huge award in this case exceeds these limits. *See* Pet.Cert., pp. 21-25; Pet.Supp.Br., pp. 5-6. Rather than confront the merits of these important constitutional questions, respondents attempt to sidestep them by misstating petitioners' argument. Petitioners do not claim that the ratio of punitive to compensatory damages is itself determinative of the excessiveness issue, nor do petitioners suggest that excessiveness may be analyzed in the abstract, "apart from the facts of the case." Resp.Br., p. 26. To the contrary, petitioners urge this Court to look at the facts in resolving the excessiveness issue because they reveal the type of extreme results that occur under California's standardless system of civil punishment: after the first trial judge ruled that the evidence did not support *any* punitive damages, a second jury imposed an $11 million punitive damages award (which was remitted to $8.5 million) to sanction petitioners for engaging in conduct that, on its face, was permitted by the express terms of valid and lawful contracts. If this scenario does not portray "punitive damages that 'run wild' " (*Pacific Mutual Life Insurance Co. v. Haslip, supra,* 59 U.S.L.W. at 4161), petitioners do not know what does.

Respondents attempt to justify this incredible result by claiming that the punitive damages award is "less than the actual injury inflicted by petitioners." Resp.Br., p. 28. The jury, however, determined that the actual damages suffered by all three respondents totaled $730,482.10 (CT 959), a mere fraction of the $8.5 million punitive damages award imposed on petitioners.[9] Respondents now attempt to inflate the amount of actual damages by referring to Pacific Trencher's gross receipts and Mr. Hilgedick's alleged "personal worth," and by speculating about certain contracts that *may* have been awarded to Pacific Trencher and Pacific Manufacturing in the future. Resp. Br., pp. 28-30. Such speculation is inappropriate here. Evidence of these matters was

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[9] Respondents try to downplay the glaring disparity between the punitive and compensatory damages in this case by falsely implying that in *Pacific Mutual* this Court approved an award of punitive damages that was 200 times as large as the compensatory damages. Resp.Br., p. 28. The ratio of punitive damages to compensatory damages in *Pacific Mutual* was not 200 to 1 but *4 to 1*, a ratio that this Court considered to be "close to the line." 59 U.S.L.W. at 4163.

put before the jurors, who presumably considered it in making their award.

CONCLUSION

For the reasons stated above and in petitioners' supplemental brief and petition for a writ of certiorari, petitioners respectfully request this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

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